

(14) *MMS-4292*—This form is used to claim an allowance for the reasonable, actual costs incurred to wash coal. Public reporting burden varies depending on the type of contract involved. Under an arm's-length contract, burden is estimated to average 1 hour for the submission of page 1 of the form requiring the lessee's name and address, payor code, accounting identification number, product code, and selling arrangement. Nonarm's-length contract claims require completion of all pages of the form including calculations of allowable operating and maintenance costs, overhead, depreciation, and return on undepreciated capital investment. Public reporting burden is estimated to average 40 hours to complete the entire form. Comments submitted relative to this information collection should reference Paperwork Reduction Project 1010-0074.

(15) *MMS-4293*—Used to claim an allowance for the reasonable, actual costs of transporting coal to a sales point or a washing facility remote from the mine or lease. Public reporting burden varies depending on the type of contract involved. Under an arm's-length contract, burden is estimated to average 1 hour for the submission of page 1 of the form requiring the lessee's name and address, payor code, accounting identification number, product code, and selling arrangement. Nonarm's-length contract claims require completion of all pages of the form including calculations of allowable operating and maintenance costs, overhead, depreciation, and return on undepreciated capital investment. Public reporting burden is estimated to average 40 hours to complete the entire form. Comments submitted relative to this information collection should reference Paperwork Reduction Project 1010-0074.

(16) *MMS-4295*—This form is used to claim an allowance for the reasonable, actual costs of transporting gas from the lease to the point of first sale. Public reporting burden varies depending on the type of contract involved. Under an arm's-length contract, burden is estimated to average 1 hour for the submission of page 1 and schedule 1 of the form requiring the lessee's name and address, payor code, accounting identi-

fication number, product code, and selling arrangement. Nonarm's-length contract claims require completion of all pages of the form including calculations of allowable operating and maintenance costs, overhead, depreciation, and return on undepreciated capital investment. Public reporting burden is estimated to average 3 hours to complete the entire form. Comments submitted relative to this information collection should reference Paperwork Reduction Project 1010-0075.

(17) *MMS-4377*—This form must be submitted by operators of stripper oil properties to notify MMS of reduced royalty rates granted by the Bureau of Land Management under 43 CFR 3193.4-1 for each 12-month qualifying period. Reporting burden is estimated to require an average of 30 minutes per form to supply the operator name, lease and agreement numbers, calculated and current royalty rate, and the period covered. Comments submitted relative to this information collection should reference Paperwork Reduction Project 1010-0090.

(18) *MMS-4430*—Submitted monthly to report production from and royalty due on all Federal and Indian solid minerals leases (see §210.201). MMS uses the data to distribute payments to appropriate recipients and to determine if lessees properly paid lease obligations. Public reporting burden is estimated to be 20 minutes per month per reporter. Comments relating to this information collection should reference OMB Control Number 1010-0120.

(19) *Facility data*—Submitted monthly by operators of wash plant, refining, ore concentration, or other processing facilities for specific solid minerals produced from specific Federal and Indian lease types or when otherwise requested by MMS (see §210.204). MMS uses the data to assure that Federal or Indian lease processed production (the output of process plants) is consistent with the input of raw production. Public reporting burden is estimated to be approximately 15 minutes per reporter per month to compile in-house formatted information and submit that information electronically. Comments relating to this information collection should reference OMB Control Number 1010-0120.

(20) *Sales contracts*—Submitted semi-annually by producers of specific solid mineral products on specific Federal and Indian lease types or when otherwise requested by MMS (see §210.203). MMS uses contracts, agreements and contract amendments for compliance purposes including, but not limited to, identifying valuation issues and establishing selling arrangement relationships. Public reporting burden is estimated to be 2 hours per reporter per year to compile and submit contracts and contract amendments. Comments relating to this information collection should reference OMB Control Number 1010-0120.

(21) *Sales summaries*—Submitted monthly by producers of specific solid minerals from specific Federal and Indian lease types or when otherwise requested by MMS (see §210.202). The MMS uses these data for compliance purposes including, but not limited to, assuring that sales volumes and values are properly attributed or allocated to Federal or Indian leases. Public reporting burden is estimated to be 15 minutes per month for each reporter to compile in-house formatted sales information and submit that information electronically. Comments relating to this information collection should reference OMB Control Number 1010-0120.

(d) *Comments on burden estimates*. Send comments on the accuracy of this burden estimate or suggestions on reducing this burden to the Minerals Management Service, Attention: Information Collection Clearance Officer, (OMB Control Number 1010-0120 (insert appropriate OMB Control Number), Mail Stop 4230, 1849 C Street, NW., Washington, DC 2024). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB Control Number.

[57 FR 41864, Sept. 14, 1992, as amended at 64 FR 38122, July 15, 1999; 66 FR 45769, Aug. 30, 2001]

§210.20 When is electronic reporting required?

(a) You must submit Forms MMS-2014 and MMS-4054 to MMS electronically. You must begin reporting electronically according to the following timetable unless you qualify for the ex-

ceptions to electronic reporting listed in §210.22:

If you report the following number of lines each month on a required form	Then, you must submit that form electronically beginning
(1) 6 or more	November 1, 1999
(2) 4-5	November 1, 2000
(3) 1-3	November 1, 2001

(b) See §218.40(c) for the definition of a royalty report line on Form MMS-2014 and §216.40(c) for the definition of a production report line on Form MMS-4054; and

(c) For purposes of this part, multiple submissions of the same form in one month equals one form.

[64 FR 33122, July 15, 1999]

§210.21 How do you report electronically?

(a) You may use any of the following electronic media types, unless MMS instructs you differently:

(1) *Electronic Data Interchange (EDI)*¹—The inter-organizational, computer-to-computer exchange of structured information in a standard, machine-processable format;

(2) *Electronic Mail (e-mail)*—Any communication service used to electronically transmit and store messages and attach files. MMS has three electronic file options:

(i) *Template*—MMS-provided software that generates blank forms on a personal computer to assist companies in preparing MMS regulatory reports (this option is not available for Form MMS-4054);

(ii) *Comma Separated Values (CSV)*—A file format where attribute fields are separated by commas; and

(iii) *American Standard Code for Information Interchange (ASCII)*—A file format of fixed-length records with fixed-length attribute fields;

(3) *Reporter-Prepared Diskette (3½ inch)*—A data storage medium used to transmit report data using one of the following file formats:

(i) Template;

(ii) CSV; and

(iii) ASCII;

¹MMS has developed security measures, authentication procedures, and automated acknowledgments for this electronic media type.

(4) Magnetic or Cartridge Tape—A data storage medium used to transmit report data in an ASCII file format.

(b) MMS prefers that you use the media types in the order presented in paragraph (a) of this section to the extent it is cost effective and practical. As technology changes, MMS will consider other media types and the order of MMS preference may change. Refer to our electronic commerce brochure for the most current reporting options. You can receive a copy of our brochure by calling your MMS representative or by accessing our Internet site at www.mmp.mms.gov.

(c) Before you may begin reporting electronically:

(1) You must submit an electronic sample of your report for MMS approval using the MMS-supplied electronic reporting guidelines;

(2) MMS must notify you that your sample report has been approved;

(3) MMS must assign you a sender identification number and security code for any EDI transmissions; and

(4) MMS must assign you an originating address and compression software password for any e-mail transmissions.

[64 FR 38123, July 15, 1999]

§ 210.22 What are the exceptions to the electronic reporting requirements?

MMS will allow the following grace periods and exceptions to the electronic reporting requirements in § 210.20:

(a) If you become a new MMS reporter after any of the dates you are required to submit electronic reports under § 210.20(a), you have 3 months from the day your first report is due to begin reporting electronically;

(b) If you exceed the maximum number of lines you are allowed to report on paper under § 210.20(a), you have 3 months from the last day of the month in which you exceeded the line limit to begin reporting electronically;

(c) You are not required to report electronically if you report only rent, minimum royalty, or other annual obligations on the Form MMS-2014; and

(d) You are not required to report electronically if you are a small business as defined by the U.S. Small Business Administration, and you have no

computer, no resources to purchase a computer or contract with an electronic reporting service, nor access to a computer at a local library or other public facility.

[64 FR 38123, July 15, 1999]

Subpart B—Oil, Gas, and OCS Sulfur—General

AUTHORITY: The Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1701 *et seq.*).

SOURCE: 49 FR 37345, Sept. 21, 1984, unless otherwise noted.

§ 210.50 Required recordkeeping.

Information required by the MMS shall be filed using the forms prescribed in this subpart, which are available from MMS. Records may be maintained in microfilm, microfiche, or other recorded media that is easily reproducible and readable.

§ 210.51 Payor information form.

The Payor Information Form (Form MMS-4025) must be filed for each Federal or Indian lease on which royalties are paid. Where specifically determined by MMS, Form MMS-4025 is also required for all Federal leases on which rent is due. The completed form must be filed by the party who is making the rent or royalty payment (payor) for each revenue source. Form MMS-4025 must be filed no later than 30 days after issuance of a new lease or a modification to an existing lease which changes the paying responsibility on the lease.

§ 210.52 Report of sales and royalty remittance.

(a) You must submit a completed Form MMS-2014 (Report of Sales and Royalty Remittance) to MMS with:

- (1) All royalty payments; and,
- (2) Rents on nonproducing leases, where specified.

(b) When you submit Form MMS 2014 data electronically, you must not submit the form itself.

(c) Completed Forms MMS-2014 for royalty payments are due by the end of the month following the production month.

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(d) Where applicable, completed Forms MMS-2014 for rental payments are due no later than the anniversary date of the lease.

(e) This section does not prohibit you from making early payments voluntarily.

[64 FR 38123, July 15, 1999]

§ 210.53 Reporting instructions.

(a) Specific guidance on how to prepare and submit required information collection reports and forms to MMS is contained in an MMS "Oil and Gas Payor Handbook," a "Production Accounting and Auditing System Reporter Handbook," and a "PAAS On-shore Oil and Gas Reporter Handbook." The Payor Handbook is available from the Minerals Management Service, Royalty Management Program, P.O. Box 5760, Denver, Colorado 80217-5760. The Reporter Handbooks are available from the Minerals Management Service, Royalty Management Program, P.O. Box 17110, Denver, Colorado 80217-0110.

(b) Royalty payors or production reporters should refer to these handbooks for specific guidance with respect to oil and gas reporting requirements. If additional information is required, the payor or reporter should contact the MMS at the above address. The appropriate telephone numbers are listed in the handbooks.

[51 FR 45882, Dec. 23, 1986, as amended at 53 FR 15412, May 9, 1988; 57 FR 41867, Sept. 14, 1992; 58 FR 64902, Dec. 10, 1993]

§ 210.54 Definitions.

Terms used in this subpart shall have the same meaning as in 30 U.S.C. 1702.

[49 FR 37345, Sept. 21, 1984. Redesignated at 51 FR 45882, Dec. 23, 1986]

§ 210.55 Special forms or reports.

(a) MMS may require you to submit additional information, forms, or reports other than those specifically referred to in this subpart. MMS will give you instructions for providing such information or filing such reports or forms. MMS will make requests for additional information, forms, or reports under this section in conformity with the Paperwork Reduction Act of 1995.

44 U.S.C. 3501, and other applicable laws.

(b) If you file a Form MMS 4025, Payor Information Form (PIF) under § 210.51, you must provide the following information to MMS upon request for each PIF:

- (1) The AID number for the lease;
- (2) The name, address, Taxpayer Identification Number (TIN), and phone number of the person for whom you are reporting and paying royalties or making other payments under the PIF;

(3) Whether the person you named in paragraph (b)(2) of this section with respect to the lease for which you filed the PIF is a:

- (i) Lessee of record (record title owner);
 - (ii) Operating rights owner (working interest owner); or
 - (iii) Operator;
- (4) The name, address, and phone number of the individual to contact for the person you named in paragraph (b)(2) of this section;

(5) Your TIN; and

(6) Whether you are the Designee of the person you named in paragraph (b)(2) of this section under 30 U.S.C. 1712(a), and, if so:

- (i) The date your designation became effective; and
- (ii) The date your designation terminates, if applicable; and
- (iii) A copy of the written designation;

(c) If you have been identified under paragraph (b)(2) of this section, you must provide the following information to MMS upon request:

(1) Confirmation that you are the person identified under paragraph (b)(2) of this section;

(2) Confirmation that the person identified in paragraph (b)(6) of this section is your designee; and

(3) A designation under § 210.52 of this title if the person identified in paragraph (b)(6) of this section is not your Designee, and if you are not reporting and paying royalties and making other payments to MMS.

[62 FR 42066, Aug. 5, 1997]

Subpart C—Federal and Indian Oil [Reserved]

(b) *When to submit.* (1) For leases with ad valorem royalty terms (that is, leases for which royalty is a percentage of the value of production), you must submit your sales summaries monthly at the same time you submit Form MMS-4430. You do not have to submit a sales summary for any month in which you did not sell Federal or Indian production.

(2) For leases with no ad valorem royalty terms (that is, leases in which the royalty due is not a function of the value of production, such as cents-per-ton or dollars-per-unit), you must submit monthly sales summaries only if we specifically request you to do so.

(c) *How to submit.* (1) You should provide the sales summary data via electronic mail where possible. We will provide instructions and the proper email address for these submissions.

(2) If you submit sales summaries by paper copy, mail them to one of the following addresses, unless MMS publishes notice in the FEDERAL REGISTER giving a different address:

(i) *For U.S. Postal Service regular mail or Express Mail:* Minerals Management Service, Minerals Revenue Management, Solid Minerals and Geothermal Compliance and Asset Management, P.O. Box 25165, MS 390G1, Denver, Colorado 80225-0165.

(ii) *For courier service or overnight mail (excluding Express Mail):* Minerals Management Service, Solid Minerals and Geothermal Compliance and Asset Management, 12600 West Colfax Avenue, Suite C-100, Lakewood, Colorado 80215.

§ 210.203 How do I submit sales contracts?

(a) *What to submit.* You must submit sales contracts, agreements, and contract amendments for the sale of all coal and other solid minerals produced from Federal and Indian leases with ad valorem royalty terms.

(b) *When to submit.* (1) For coal and metal production, you must submit the required documents semi-annually, no later than March 30 and September 30 of each year.

(2) For sodium, potassium, and phosphate production, and production from any other lease with ad valorem royalty terms, you must submit the re-

quired documents only if you are specifically requested to do so.

(c) *How to submit.* You must submit complete copies of the sales contracts and amendments to us at the applicable address given in § 210.202(c)(2), unless MMS publishes notice in the FEDERAL REGISTER giving a different address.

§ 210.204 How do I submit facility data?

(a) *What to submit.* (1) You must submit facility data if you operate a wash plant, refining, ore concentration, or other processing facility for any coal, sodium, potassium, metals, or other solid minerals produced from Federal or Indian leases with ad valorem royalty terms, regardless of whether the facility is located on or off the lease.

(2) You do not have to submit facility data for those months in which you do not process solid minerals produced from Federal or Indian leases and do not have any such minerals in stockpile inventory.

(3) You must include in your facility data all production processed in the facility from all properties, not just production from Federal and Indian leases.

(4) Facility data submissions must include the following minimum information:

- (i) Identification of your facility;
- (ii) Mines served;
- (iii) Input quantity;
- (iv) Input quality or ore grade (except for coal);
- (v) Output quantity; and
- (vi) Output quality or product grades.

(5) Your submitted facility data may be internally generated documents from your own records. You do not need to re-format them before submitting them to us.

(b) *When to submit.* You must submit your facility data monthly at the same time you submit your Form MMS-4430.

(c) *How to submit.* (1) You should provide the facility data via electronic mail where possible. We will provide instructions and the proper email address for these submissions before you begin reporting.

(2) If you submit facility data by paper copy, send it to the applicable address given in § 210.202(c)(2).

§ 210.205 Will I need to submit additional documents or evidence to MMS?

(a) Federal and Indian lease terms allow us to request detailed statements, documents, or other evidence necessary to verify compliance with lease terms and conditions and applicable rules.

(b) We will request this additional information as we need it, not as a regular submission.

§ 210.206 How will information submissions be kept confidential?

Information submitted under this part that constitutes trade secrets or commercial and financial information that is identified as privileged or confidential, or that is exempt from disclosure under the Freedom of Information Act, 5 U.S.C. 552, shall not be available for public inspection or made public or disclosed without the consent of the lessee, except as otherwise provided by law or regulation.

Subpart F—Coal [Reserved]

Subpart G—Other Solid Minerals [Reserved]

Subpart H—Geothermal Resources

SOURCE: 56 FR 57286, Nov. 8, 1991, unless otherwise noted.

§ 210.350 Definitions.

Terms used in this subpart shall have the same meaning as in 30 CFR 206.351.

§ 210.351 Required recordkeeping.

Information required by MMS shall be filed using the forms prescribed in this subpart, which are available from MMS. Records may be maintained on microfilm, microfiche, or other recorded media that are easily reproducible and readable. See subpart H of 30 CFR part 212.

§ 210.352 Payor information forms.

The Payor Information Form (Form MMS-4025) must be filed for each Federal lease on which geothermal royalties (including byproduct royalties) are paid. Where specifically determined by

MMS, Form MMS-4025 is also required for all Federal leases on which rent is due. The completed form must be filed by the party who is making the rent or royalty payment (payor) for each revenue source. Form MMS-4025 must be filed no later than 30 days after issuance of a new lease or a modification to an existing lease that changes the paying responsibility on the lease. The Form MMS-4025 shall identify the payor of production royalty, and identify revenue sources and selling arrangements for all leased geothermal resources (including byproducts). After filing the initial form, a new Form MMS-4025 must be filed no later than 30 days after the occurrence of any of the following:

- (a) Assignment of all or any part of the lease;
- (b) Production of new product;
- (c) A change in a selling arrangement;
- (d) Change in royalty rate;
- (e) Change of payor; or
- (f) Abandonment of a lease.

§ 210.353 Special forms and reports.

The MMS may require submission of additional information on special forms or reports. When special forms or reports other than those referred to in this subpart are necessary, MMS will give instructions for the filing of such forms or reports. Requests for the submission of such forms will be made in conformity with the requirements of the Paperwork Reduction Act of 1980 and other applicable laws.

§ 210.354 Monthly report of sales and royalty.

A completed Report of Sales and Royalty Remittance (Form MMS-2014) must be submitted each month once sales or utilization of production occur, even though sales may be intermittent, unless otherwise authorized by MMS. This report is due on or before the last day of the month following the month in which production was sold or utilized, together with the royalties due the United States.

§ 210.355 Reporting instructions.

(a) Specific guidance on how to prepare and submit required information collection reports and forms to MMS is

as compared to arm's-length transportation charges by pipelines, owned by the lessee or others, providing similar transportation services in that area. If there are no arm's-length transportation charges, MMS shall deny the exception request if:

(i) No FERC cost analysis exists and the FERC has declined to investigate under MMS timely objections upon filing; and

(ii) the tariff significantly exceeds the lessee's actual costs for transportation as determined under this section.

(c) *Reporting requirements.* (1) *Arm's-length contracts.* (i) With the exception of those transportation allowances specified in paragraphs (c)(1)(v) and (c)(1)(vi) of this section, the lessee shall submit page one of the initial Form MMS 4110 (and Schedule 1), Oil Transportation Allowance Report, prior to, or at the same time as, the transportation allowance determined, under an arm's-length contract, is reported on Form MMS 2014, Report of Sales and Royalty Remittance. A Form MMS-4110 received by the end of the month that the Form MMS-2014 is due shall be considered to be timely received.

(ii) The initial Form MMS-4110 shall be effective for a reporting period beginning the month that the lessee is first authorized to deduct a transportation allowance and shall continue until the end of the calendar year, or until the applicable contract or rate terminates or is modified or amended, whichever is earlier.

(iii) After the initial reporting period and for succeeding reporting periods, lessees must submit page one of Form MMS-4110 (and Schedule 1) within 3 months after the end of the calendar year, or after the applicable contract or rate terminates or is modified or amended, whichever is earlier, unless MMS approves a longer period (during which period the lessee shall continue to use the allowance from the previous reporting period).

(iv) MMS may require that a lessee submit arm's-length transportation contracts, production agreements, operating agreements, and related documents. Documents shall be submitted

within a reasonable time, as determined by MMS.

(v) Transportation allowances which are based on arm's-length contracts and which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate. For the purposes of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

(vi) MMS may establish, in appropriate circumstances, reporting requirements which are different from the requirements of this section.

(2) *Non-arm's-length or no contract.* (i) With the exception of those transportation allowances specified in paragraphs (c)(2)(v), (c)(2)(vii) and (c)(2)(viii) of this section, the lessee shall submit an initial Form MMS-4110 prior to, or at the same time as, the transportation allowance determined under a non-arm's-length contract or no-contract situation is reported on Form MMS-2014. A Form MMS-4110 received by the end of the month that the Form MMS-2014 is due shall be considered to be timely received. The initial report may be based upon estimated costs.

(ii) The initial Form MMS-4110 shall be effective for a reporting period beginning the month that the lessee first is authorized to deduct a transportation allowance and shall continue until the end of the calendar year, or until transportation under the non-arm's-length contract or the no-contract situation terminates, whichever is earlier.

(iii) For calendar-year reporting periods succeeding the initial reporting period, the lessee shall submit a completed Form MMS-4110 containing the actual costs for the previous reporting period. If oil transportation is continuing, the lessee shall include on Form MMS-4110 its estimated costs for the next calendar year. The estimated oil transportation allowance shall be based on the actual costs for the previous reporting period plus or minus any adjustments which are based on the lessee's knowledge of decreases or increases that will affect the allowance. MMS must receive the Form

MMS 4110 within 3 months after the end of the previous reporting period, unless MMS approves a longer period (during which period the lessee shall continue to use the allowance from the previous reporting period).

(iv) For new transportation facilities or arrangements, the lessee's initial Form MMS 4110 shall include estimates of the allowable oil transportation costs for the applicable period. Cost estimates shall be based upon the most recently available operations data for the transportation system or, if such data are not available, the lessee shall use estimates based upon industry data for similar transportation systems.

(v) Non-arm's-length contract or no-contract transportation allowances which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate. For the purposes of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

(vi) Upon request by MMS, the lessee shall submit all data used to prepare its Form MMS-4110. The data shall be provided within a reasonable period of time, as determined by MMS.

(vii) MMS may establish, in appropriate circumstances, reporting requirements which are different from the requirements of this section.

(viii) If the lessee is authorized to use its FERC-approved tariff as its transportation cost in accordance with paragraph (b)(5) of this section, it shall follow the reporting requirements of paragraph (c)(1) of this section.

(3) MMS may establish reporting dates for individual lessees different from those specified in this subpart in order to provide more effective administration. Lessees will be notified of any change in their reporting period.

(4) Transportation allowances must be reported as a separate line item on Form MMS 2014, unless MMS approves a different reporting procedure.

(d) *Interest assessments for incorrect or late reports and for failure to report.* (1) If a lessee deducts a transportation allowance on its Form MMS-2014 without complying with the requirements of

this section, the lessee shall pay interest only on the amount of such deduction until the requirements of this section are complied with. The lessee also shall repay the amount of any allowance which is disallowed by this section.

(2) If a lessee erroneously reports a transportation allowance which results in an underpayment of royalties, interest shall be paid on the amount of that underpayment.

(3) Interest required to be paid by this section shall be determined in accordance with 30 CFR 218.54.

(e) *Adjustments.* (1) If the actual transportation allowance is less than the amount the lessee has taken on Form MMS-2014 for each month during the allowance form reporting period, the lessee shall be required to pay additional royalties due plus interest computed under 30 CFR 218.54, retroactive to the first day of the first month the lessee is authorized to deduct a transportation allowance. If the actual transportation allowance is greater than the amount the lessee has taken on Form MMS-2014 for each month during the allowance form reporting period, the lessee shall be entitled to a credit without interest.

(2) For lessees transporting production from Indian leases, the lessee must submit a corrected Form MMS-2014 to reflect actual costs, together with any payment, in accordance with instructions provided by MMS.

(f) *Actual or theoretical losses.* Notwithstanding any other provisions of this subpart, for other than arm's-length contracts, no cost shall be allowed for oil transportation which results from payments (either volumetric or for value) for actual or theoretical losses. This section does not apply when the transportation allowance is based upon a FERC or State regulatory agency approved tariff.

(g) *Other transportation cost determinations.* The provisions of this section shall apply to determine transportation costs when establishing value using a netback valuation procedure or any other procedure that requires deduction of transportation costs.

(g) The MMS or the Assistant Secretary generally will not retroactively modify or rescind a value determination issued under paragraph (d) of this section, unless:

- (1) There was a misstatement or omission of material facts; or
 - (2) The facts subsequently developed are materially different from the facts on which the guidance was based.
- (h) MMS may make requests and replies under this section available to the public, subject to the confidentiality requirements under § 206.108.

§ 206.108 Does MMS protect information I provide?

Certain information you submit to MMS regarding valuation of oil, including transportation allowances, may be exempt from disclosure. To the extent applicable laws and regulations permit, MMS will keep confidential any data you submit that is privileged, confidential, or otherwise exempt from disclosure. All requests for information must be submitted under the Freedom of Information Act regulations of the Department of the Interior at 43 CFR part 2.

§ 206.109 When may I take a transportation allowance in determining value?

(a) *Transportation allowances permitted when value is based on gross proceeds.* MMS will allow a deduction for the reasonable, actual costs to transport oil from the lease to the point off the lease under §§ 206.110 or 206.111, as applicable. This paragraph applies when:

- (1) You value oil under § 206.102 based on gross proceeds from a sale at a point off the lease, unit, or communized area where the oil is produced, and
- (2) The movement to the sales point is not gathering.

(b) *Transportation allowances and other adjustments that apply when value is based on index pricing.* If you value oil using an index price under § 206.103, MMS will allow a deduction for certain location/quality adjustments and certain costs associated with transporting oil as provided under § 206.112.

(c) *Limits on transportation allowances.* (1) Except as provided in paragraph (c)(2) of this section, your transportation allowance may not exceed 50

percent of the value of the oil as determined under § 206.102 or § 206.103 of this subpart. You may not use transportation costs incurred to move a particular volume of production to reduce royalties owed on production for which those costs were not incurred.

(2) You may ask MMS to approve a transportation allowance in excess of the limitation in paragraph (c)(1) of this section. You must demonstrate that the transportation costs incurred were reasonable, actual, and necessary. Your application for exception (using Form MMS-4393, Request to Exceed Regulatory Allowance Limitation) must contain all relevant and supporting documentation necessary for MMS to make a determination. You may never reduce the royalty value of any production to zero.

(d) *Allocation of transportation costs.* You must allocate transportation costs among all products produced and transported as provided in §§ 206.110 and 206.111. You must express transportation allowances for oil as dollars per barrel.

(e) *Liability for additional payments.* If MMS determines that you took an excessive transportation allowance, then you must pay any additional royalties due, plus interest under 30 CFR 218.54. You also could be entitled to a credit with interest under applicable rules if you understated your transportation allowance. If you take a deduction for transportation on Form MMS-2014 by improperly netting the allowance against the sales value of the oil instead of reporting the allowance as a separate entry, MMS may assess you an amount under § 206.116.

§ 206.110 How do I determine a transportation allowance under an arm's-length transportation contract?

(a) If you or your affiliate incur transportation costs under an arm's-length transportation contract, you may claim a transportation allowance for the reasonable, actual costs incurred for transporting oil under that contract, except as provided in paragraphs (a)(1) and (a)(2) of this section and subject to the limitation in § 206.109(c). You must be able to demonstrate that your contract is arm's

length. You do not need MMS approval before reporting a transportation allowance for costs incurred under an arm's-length transportation contract.

(1) If MMS determines that the contract reflects more than the consideration actually transferred either directly or indirectly from you or your affiliate to the transporter for the transportation, MMS may require that you calculate the transportation allowance under § 206.111.

(2) You must calculate the transportation allowance under § 206.111 if MMS determines that the consideration paid under an arm's-length transportation contract does not reflect the reasonable value of the transportation due to either:

(i) Misconduct by or between the parties to the arm's-length contract; or

(ii) Breach of your duty to market the oil for the mutual benefit of yourself and the lessor.

(A) MMS will not use this provision to simply substitute its judgment of the reasonable oil transportation costs incurred by you or your affiliate under an arm's-length transportation contract.

(B) The fact that the cost you or your affiliate incur in an arm's-length transaction is higher than other measures of transportation costs, such as rates paid by others in the field or area, is insufficient to establish breach of the duty to market unless MMS finds additional evidence that you or your affiliate acted unreasonably or in bad faith in transporting oil from the lease.

(b) If your arm's-length transportation contract includes more than one liquid product, and the transportation costs attributable to each product cannot be determined from the contract, then you must allocate the total transportation costs to each of the liquid products transported.

(1) Your allocation must use the same proportion as the ratio of the volume of each product (excluding waste products with no value) to the volume of all liquid products (excluding waste products with no value).

(2) You may not claim an allowance for the costs of transporting lease production that is not royalty-bearing.

(3) You may propose to MMS a cost allocation method on the basis of the

values of the products transported. MMS will approve the method unless it is not consistent with the purposes of the regulations in this subpart.

(c) If your arm's-length transportation contract includes both gaseous and liquid products, and the transportation costs attributable to each product cannot be determined from the contract, then you must propose an allocation procedure to MMS.

(1) You may use your proposed procedure to calculate a transportation allowance until MMS accepts or rejects your cost allocation. If MMS rejects your cost allocation, you must amend your Form MMS-2014 for the months that you used the rejected method and pay any additional royalty and interest due.

(2) You must submit your initial proposal, including all available data, within 3 months after first claiming the allocated deductions on Form MMS-2014.

(d) If your payments for transportation under an arm's-length contract are not on a dollar-per-unit basis, you must convert whatever consideration is paid to a dollar-value equivalent.

(e) If your arm's-length sales contract includes a provision reducing the contract price by a transportation factor, do not separately report the transportation factor as a transportation allowance on Form MMS-2014.

(1) You may use the transportation factor in determining your gross proceeds for the sale of the product.

(2) You must obtain MMS approval before claiming a transportation factor in excess of 50 percent of the base price of the product.

§ 206.111 How do I determine a transportation allowance under a non-arm's-length transportation arrangement?

(a) If you or your affiliate have a non-arm's-length transportation contract or no contract, including those situations where you or your affiliate perform your own transportation services, calculate your transportation allowance based on your or your affiliate's reasonable, actual transportation costs using the procedures provided in this section.

three adjustments from those exchanges to determine the adjustment under this subparagraph. (If one of the three exchanges was not at arm's length, you must request MMS approval under paragraph (b) of this section for the location/quality adjustment for that exchange to determine the total location/quality adjustment for the three exchanges.) You also could have a combination of these examples.

(2) You may adjust the index price for actual transportation costs, determined under § 206.110 or § 206.111:

(i) From the lease to the first point where you give your oil in exchange; and

(ii) From any intermediate point where you receive oil in exchange to another intermediate point where you give the oil in exchange again; and

(iii) From the point where you receive oil in exchange and transport it without further exchange to a market center, or to a refinery that is not at a market center.

(b) For non-arm's-length exchange agreements, you must request approval from MMS for any location/quality adjustment.

(c) If you transport lease production directly to a market center or to an alternate disposal point (for example, your refinery), you may adjust the index price for your actual transportation costs, determined under § 206.110 or § 206.111.

(d) If you adjust for location/quality or transportation costs under paragraphs (a), (i), or (c) of this section, also adjust the index price for quality based on premia or penalties determined by pipeline quality bank specifications at intermediate commingling points or at the market center. Make this adjustment only if and to the extent that such adjustments were not already included in the location/quality differentials determined from your arm's-length exchange agreements.

(e) For leases in the Rocky Mountain Region, for purposes of this section, the term "market center" means Cushing, Oklahoma, unless MMS specifies otherwise through notice published in the FEDERAL REGISTER.

(f) If you cannot determine your location/quality adjustment under para-

graph (a) or (c) of this section, you must request approval from MMS for any location/quality adjustment.

(g) You may not use any transportation or quality adjustment that duplicates all or part of any other adjustment that you use under this section.

§ 206.113 How will MMS identify market centers?

MMS periodically will publish in the *FEDERAL REGISTER* a list of market centers. MMS will monitor market activity and, if necessary, add to or modify the list of market centers and will publish such modifications in the *FEDERAL REGISTER*. MMS will consider the following factors and conditions in specifying market centers:

(a) Points where MMS-approved publications publish prices useful for index purposes;

(b) Markets served;

(c) Input from industry and others knowledgeable in crude oil marketing and transportation;

(d) Simplification; and

(e) Other relevant matters.

§ 206.114 What are my reporting requirements under an arm's-length transportation contract?

You or your affiliate must use a separate entry on Form MMS-2014 to notify MMS of an allowance based on transportation costs you or your affiliate incur. MMS may require you or your affiliate to submit arm's-length transportation contracts, production agreements, operating agreements, and related documents. Recordkeeping requirements are found at part 207 of this chapter.

§ 206.115 What are my reporting requirements under a non-arm's-length transportation arrangement?

(a) You or your affiliate must use a separate entry on Form MMS-2014 to notify MMS of an allowance based on transportation costs you or your affiliate incur.

(b) For new transportation facilities or arrangements, base your initial deduction on estimates of allowable oil transportation costs for the applicable period. Use the most recently available operations data for the transportation

system or, if such data are not available, use estimates based on data for similar transportation systems. Section 206.117 will apply when you amend your report based on your actual costs.

(c) MMS may require you or your affiliate to submit all data used to calculate the allowance deduction. Recordkeeping requirements are found at part 207 of this chapter.

§ 206.116 What interest and assessments apply if I improperly report a transportation allowance?

(a) If you or your affiliate net a transportation allowance rather than report it as a separate entry against the royalty value on Form MMS-2014, you will be assessed an amount up to 10 percent of the netted allowance, not to exceed \$250 per lease selling arrangement per sales period.

(b) If you or your affiliate deduct a transportation allowance on Form MMS-2014 that exceeds 50 percent of the value of the oil transported without obtaining MMS's prior approval under § 206.109, you must pay interest on the excess allowance amount taken from the date that amount is taken to the date you or your affiliate file an exception request that MMS approves. If you do not file an exception request, or if MMS does not approve your request, you must pay interest on the excess allowance amount taken from the date that amount is taken until the date you pay the additional royalties owed.

§ 206.117 What reporting adjustments must I make for transportation allowances?

(a) If your or your affiliate's actual transportation allowance is less than the amount you claimed on Form MMS-2014 for each month during the allowance reporting period, you must pay additional royalties plus interest computed under 30 CFR 218.54 from the date you took the deduction to the date you repay the difference.

(b) If the actual transportation allowance is greater than the amount you claimed on Form MMS-2014 for any month during the allowance form reporting period, you are entitled to a credit plus interest under applicable rules.

§ 206.118 Are actual or theoretical losses permitted as part of a transportation allowance?

You are allowed a deduction for oil transportation which results from payments that you make (either volumetric or for value) for actual or theoretical losses only under an arm's-length contract. You may not take such a deduction under a non-arm's-length contract.

§ 206.119 How are royalty quantity and quality determined?

(a) Compute royalties based on the quantity and quality of oil as measured at the point of settlement approved by BLM for onshore leases or MMS for offshore leases.

(b) If the value of oil determined under this subpart is based upon a quantity or quality different from the quantity or quality at the point of royalty settlement approved by the BLM for onshore leases or MMS for offshore leases, adjust the value for those differences in quantity or quality.

(c) You may not claim a deduction from the royalty volume or royalty value for actual or theoretical losses except as provided in § 206.118. Any actual loss that you may incur before the royalty settlement metering or measurement point is not subject to royalty if BLM or MMS, as appropriate, determines that the loss is unavoidable.

(d) Except as provided in paragraph (b) of this section, royalties are due on 100 percent of the volume measured at the approved point of royalty settlement. You may not claim a reduction in that measured volume for actual losses beyond the approved point of royalty settlement or for theoretical losses that are claimed to have taken place either before or after the approved point of royalty settlement.

§ 206.120 How are operating allowances determined?

MMS may use an operating allowance for the purpose of computing payment obligations when specified in the notice of sale and the lease. MMS will specify the allowance amount or formula in the notice of sale and in the lease agreement.

downstream of the point of royalty settlement without resorting to processing determined pursuant to § 206.102 of this subpart; or (2) the value, for royalty purposes, of the gas prior to processing determined in accordance with § 206.152 of this subpart.

(b) The requirement for accounting for comparison contained in the terms of leases will govern as provided in § 206.159(b) of this subpart. When accounting for comparison is required by the lease terms, such accounting for comparison shall be determined in accordance with paragraph (a) of this section.

[53 FR 1272, Jan. 15, 1988, as amended at 61 FR 5465, Feb. 12, 1996]

§ 206.156 Transportation allowances—general.

(a) Where the value of gas has been determined pursuant to § 206.152 or § 206.153 of this subpart at a point (e.g., sales point or point of value determination) off the lease, MMS shall allow a deduction for the reasonable actual costs incurred by the lessee to transport unprocessed gas, residue gas, and gas plant products from a lease to a point off the lease including, if appropriate, transportation from the lease to a gas processing plant off the lease and from the plant to a point away from the plant.

(b) Transportation costs must be allocated among all products produced and transported as provided in § 206.157.

(c)(1) Except as provided in paragraph (c)(3) of this section, for unprocessed gas valued in accordance with § 206.152 of this subpart, the transportation allowance deduction on the basis of a selling arrangement shall not exceed 50 percent of the value of the unprocessed gas determined in accordance with § 206.152 of this subpart.

(2) Except as provided in paragraph (c)(3) of this section, for gas production valued in accordance with § 206.153 of this subpart the transportation allowance deduction on the basis of a selling arrangement shall not exceed 50 percent of the value of the residue gas or gas plant product determined in accordance with § 206.153 of this subpart. For purposes of this section, natural gas liquids shall be considered one product.

(3) Upon request of a lessee, MMS may approve a transportation allowance deduction in excess of the limitations prescribed by paragraphs (c)(1) and (c)(2) of this section. The lessee must demonstrate that the transportation costs incurred in excess of the limitations prescribed in paragraphs (c)(1) and (c)(2) of this section were reasonable, actual, and necessary. An application for exception (using Form MMS-4393, Request to Exceed Regulatory Allowance Limitation) shall contain all relevant and supporting documentation necessary for MMS to make a determination. Under no circumstances shall the value for royalty purposes under any selling arrangement be reduced to zero.

(d) If, after a review and/or audit, MMS determines that a lessee has improperly determined a transportation allowance authorized by this subpart, then the lessee shall pay any additional royalties, plus interest, determined in accordance with 30 CFR 218.54, or shall be entitled to a credit, without interest. If the lessee takes a deduction for transportation on the Form MMS-2014 by improperly netting the allowance against the sales value of the unprocessed gas, residue gas, and gas plant products instead of reporting the allowance as a separate line item, he may be assessed an additional amount under 206.157(d).

[53 FR 1272, Jan. 15, 1988, as amended at 61 FR 5465, Feb. 12, 1996; 64 FR 43288, Aug. 10, 1999]

§ 206.157 Determination of transportation allowances.

(a) *Arm's-length transportation contracts.* (1)(i) For transportation costs incurred by a lessee under an arm's-length contract, the transportation allowance shall be the reasonable, actual costs incurred by the lessee for transporting the unprocessed gas, residue gas and/or gas plant products under that contract, except as provided in paragraphs (a)(1)(ii) and (a)(1)(iii) of this section, subject to monitoring, review, audit, and adjustment. The lessee shall have the burden of demonstrating that its contract is arm's-length. MMS' prior approval is not required before a lessee may deduct costs incurred under

an arm's-length contract. Such allowances shall be subject to the provisions of paragraph (f) of this section. The lessee must claim a transportation allowance by reporting it as a separate line entry on the Form MMS-2014.

(ii) In conducting reviews and audits, MMS will examine whether or not the contract reflects more than the consideration actually transferred either directly or indirectly from the lessee to the transporter for the transportation. If the contract reflects more than the total consideration, then the MMS may require that the transportation allowance be determined in accordance with paragraph (b) of this section.

(iii) If the MMS determines that the consideration paid pursuant to an arm's-length transportation contract does not reflect the reasonable value of the transportation because of misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor, then MMS shall require that the transportation allowance be determined in accordance with paragraph (b) of this section. When MMS determines that the value of the transportation may be unreasonable, MMS will notify the lessee and give the lessee an opportunity to provide written information justifying the lessee's transportation costs.

(2)(i) If an arm's-length transportation contract includes more than one product in a gaseous phase and the transportation costs attributable to each product cannot be determined from the contract, the total transportation costs shall be allocated in a consistent and equitable manner to each of the products transported in the same proportion as the ratio of the volume of each product (excluding waste products which have no value) to the volume of all products in the gaseous phase (excluding waste products which have no value). Except as provided in this paragraph, no allowance may be taken for the costs of transporting lease production which is not royalty bearing without MMS approval.

(ii) Notwithstanding the requirements of paragraph (i), the lessee may propose to MMS a cost allocation method on the basis of the values of

the products transported. MMS shall approve the method unless it determines that it is not consistent with the purposes of the regulations in this part.

(3) If an arm's-length transportation contract includes both gaseous and liquid products and the transportation costs attributable to each cannot be determined from the contract, the lessee shall propose an allocation procedure to MMS. The lessee may use the transportation allowance determined in accordance with its proposed allocation procedure until MMS issues its determination on the acceptability of the cost allocation. The lessee shall submit all relevant data to support its proposal. MMS shall then determine the gas transportation allowance based upon the lessee's proposal and any additional information MMS deems necessary. The lessee must submit the allocation proposal within 3 months of claiming the allocated deduction on the Form MMS-2014.

(4) Where the lessee's payments for transportation under an arm's-length contract are not based on a dollar per unit, the lessee shall convert whatever consideration is paid to a dollar value equivalent for the purposes of this section.

(5) Where an arm's-length sales contract price or a posted price includes a provision whereby the listed price is reduced by a transportation factor, MMS will not consider the transportation factor to be a transportation allowance. The transportation factor may be used in determining the lessee's gross proceeds for the sale of the product. The transportation factor may not exceed 50 percent of the base price of the product without MMS approval.

(b) *Non-arm's-length or no contract.* (1) If a lessee has a non-arm's-length transportation contract or has no contract, including those situations where the lessee performs transportation services for itself, the transportation allowance will be based upon the lessee's reasonable actual costs as provided in this paragraph. All transportation allowances deducted under a non-arm's-length or no contract situation are subject to monitoring, review, audit, and adjustment. The lessee must claim a transportation allowance by

reporting it as a separate line entry on the Form MMS-2014. When necessary or appropriate, MMS may direct a lessee to modify its estimated or actual transportation allowance deduction.

(2) The transportation allowance for non-arm's-length or no-contract situations shall be based upon the lessee's actual costs for transportation during the reporting period, including operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment in accordance with paragraph (b)(2)(iv)(A) of this section, or a cost equal to the initial depreciable investment in the transportation system multiplied by a rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those costs for depreciable fixed assets (including costs of delivery and installation of capital equipment) which are an integral part of the transportation system.

(i) Allowable operating expenses include: Operations supervision and engineering; operations labor; fuel; utilities; materials; ad valorem property taxes; rent; supplies; and any other directly allocable and attributable operating expense which the lessee can document.

(ii) Allowable maintenance expenses include: Maintenance of the transportation system; maintenance of equipment; maintenance labor; and other directly allocable and attributable maintenance expenses which the lessee can document.

(iii) Overhead directly attributable and allocable to the operation and maintenance of the transportation system is an allowable expense. State and Federal income taxes and severance taxes and other fees, including royalties, are not allowable expenses.

(iv) A lessee may use either depreciation or a return on depreciable capital investment. After a lessee has elected to use either method for a transportation system, the lessee may not later elect to change to the other alternative without approval of the MMS.

(A) To compute depreciation, the lessee may elect to use either a straight-line depreciation method based on the life of equipment or on the life of the reserves which the transportation sys-

tem services, or a unit of production method. After an election is made, the lessee may not change methods without MMS approval. A change in ownership of a transportation system shall not alter the depreciation schedule established by the original transporter/lessee for purposes of the allowance calculation. With or without a change in ownership, a transportation system shall be depreciated only once. Equipment shall not be depreciated below a reasonable salvage value.

(B) The MMS shall allow as a cost an amount equal to the allowable initial capital investment in the transportation system multiplied by the rate of return determined pursuant to paragraph (b)(2)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to transportation facilities first placed in service after March 1, 1988.

(v) The rate of return must be the industrial rate associated with Standard and Poor's BBB rating. The rate of return must be the monthly average rate as published in Standard and Poor's Bond Guide for the first month for which the allowance is applicable. The rate must be redetermined at the beginning of each subsequent calendar year.

(3)(i) The deduction for transportation costs shall be determined on the basis of the lessee's cost of transporting each product through each individual transportation system. Where more than one product in a gaseous phase is transported, the allocation of costs to each of the products transported shall be made in a consistent and equitable manner in the same proportion as the ratio of the volume of each product (excluding waste products which have no value) to the volume of all products in the gaseous phase (excluding waste products which have no value). Except as provided in this paragraph, the lessee may not take an allowance for transporting a product which is not royalty bearing without MMS approval.

(ii) Notwithstanding the requirements of paragraph (3)(3)(i), the lessee may propose to the MMS a cost allocation method on the basis of the values of the products transported. MMS shall

approve the method unless it determines that it is not consistent with the purposes of the regulations in this part.

(4) Where both gaseous and liquid products are transported through the same transportation system, the lessee shall propose a cost allocation procedure to MMS. The lessee may use the transportation allowance determined in accordance with its proposed allocation procedure until MMS issues its determination on the acceptability of the cost allocation. The lessee shall submit all relevant data to support its proposal. MMS shall then determine the transportation allowance based upon the lessee's proposal and any additional information MMS deems necessary. The lessee must submit the allocation proposal within 3 months of claiming the allocated deduction on the Form MMS-2014.

(5) A lessee may apply to the MMS for an exception from the requirement that it compute actual costs in accordance with paragraphs (b)(1) through (b)(4) of this section. The MMS will grant the exception only if the lessee has a tariff for the transportation system approved by the Federal Energy Regulatory Commission (FERC) (for both Federal and Indian leases) or a State regulatory agency (for Federal leases). The MMS shall deny the exception request if it determines that the tariff is excessive as compared to arm's-length transportation charges by pipelines, owned by the lessee or others, providing similar transportation services in that area. If there are no arm's-length transportation charges, MMS shall deny the exception request if: (i) No FERC or State regulatory agency cost analysis exists and the FERC or State regulatory agency, as applicable, has declined to investigate pursuant to MMS timely objections upon filing; and (ii) the tariff significantly exceeds the lessee's actual costs for transportation as determined under this section.

(c) *Reporting requirements.* (1) *Arm's-length contracts.* (i) The lessee must notify MMS of an allowance based on incurred costs by using a separate line entry on the Form MMS-2014.

(ii) The MMS may require that a lessee submit arm's-length transportation

contracts, production agreements, operating agreements, and related documents. Documents shall be submitted within a reasonable time, as determined by MMS.

(2) *Non-arm's-length or no contract.* (i) The lessee must notify MMS of an allowance based on the incurred costs by using a separate line entry on the Form MMS-2014.

(ii) For new transportation facilities or arrangements, the lessee's initial deduction shall include estimates of the allowable gas transportation costs for the applicable period. Cost estimates shall be based upon the most recently available operations data for the transportation system or, if such data are not available, the lessee shall use estimates based upon industry data for similar transportation systems.

(iii) Upon request by MMS, the lessee shall submit all data used to prepare the allowance deduction. The data shall be provided within a reasonable period of time, as determined by MMS.

(iv) If the lessee is authorized to use its FERC-approved or State regulatory agency-approved tariff as its transportation cost in accordance with paragraph (b)(5) of this section, it shall follow the reporting requirements of paragraph (c)(1) of this section.

(d) *Interest and assessments.* (1) If a lessee nets a transportation allowance against the royalty value on the Form MMS-2014, the lessee shall be assessed an amount of up to 10 percent of the allowance netted not to exceed \$250 per lease selling arrangement per sales period.

(2) If a lessee deducts a transportation allowance on its Form MMS-2014 that exceeds 50 percent of the value of the gas transported without obtaining prior approval of MMS under § 206.156, the lessee shall pay interest on the excess allowance amount taken from the date such amount is taken to the date the lessee files an exception request with MMS.

(3) If a lessee erroneously reports a transportation allowance which results in an underpayment of royalties, interest shall be paid on the amount of that underpayment.

(4) Interest required to be paid by this section shall be determined in accordance with 30 CFR 218.54.

(e) *Adjustments.* (1) If the actual transportation allowance is less than the amount the lessee has taken on Form MMS-2014 for each month during the allowance reporting period, the lessee shall be required to pay additional royalties due plus interest computed under 30 CFR 218.54 from the allowance reporting period when the lessee took the deduction to the date the lessee repays the difference to MMS. If the actual transportation allowance is greater than the amount the lessee has taken on Form MMS-2014 for each month during the allowance reporting period, the lessee shall be entitled to a credit without interest.

(2) For lessees transporting production from onshore Federal leases, the lessee must submit a corrected Form MMS-2014 to reflect actual costs, together with any payment, in accordance with instructions provided by MMS.

(3) For lessees transporting gas production from leases on the OCS, if the lessee's estimated transportation allowance exceeds the allowance based on actual costs, the lessee must submit a corrected Form MMS-2014 to reflect actual costs, together with its payment, in accordance with instructions provided by MMS. If the lessee's estimated transportation allowance is less than the allowance based on actual costs, the refund procedure will be specified by MMS.

(f) *Allowable costs in determining transportation allowances.* Lessees may include, but are not limited to, the following costs in determining the arm's-length transportation allowance under paragraph (a) of this section or the non-arm's-length transportation allowance under paragraph (b) of this section:

(1) *Firm demand charges paid to pipelines.* You must limit the allowable costs for the firm demand charges to the applicable rate per MMBtu multiplied by the actual volumes transported. You may not include any losses incurred for previously purchased but unused firm capacity. You also may not include any gains associated with releasing firm capacity. If you receive a payment or credit from the pipeline for penalty refunds, rate case refunds, or other reasons, you must reduce the

firm demand charge claimed on the Form MMS-2014. You must modify the Form MMS-2014 by the amount received or credited for the affected reporting period;

(2) *Gas supply realignment (GSR) costs.* The GSR costs result from a pipeline reforming or terminating supply contracts with producers to implement the restructuring requirements of FERC Orders in 18 CFR part 284;

(3) *Commodity charges.* The commodity charge allows the pipeline to recover the costs of providing service;

(4) *Wheeling costs.* Hub operators charge a wheeling cost for transporting gas from one pipeline to either the same or another pipeline through a market center or hub. A hub is a connected manifold of pipelines through which a series of incoming pipelines are interconnected to a series of outgoing pipelines;

(5) *Gas Research Institute (GRI) fees.* The GRI conducts research, development, and commercialization programs on natural gas related topics for the benefit of the U.S. gas industry and gas customers. GRI fees are allowable provided such fees are mandatory in FERC-approved tariffs;

(6) *Annual Charge Adjustment (ACA) fees.* FERC charges these fees to pipelines to pay for its operating expenses;

(7) *Payments (either volumetric or in value) for actual or theoretical losses.* This paragraph does not apply to non-arm's-length transportation arrangements unless the transportation allowance is based on a FERC or State regulatory-approved tariff;

(8) *Temporary storage services.* This includes short duration storage services offered by market centers or hubs (commonly referred to as "parking" or "banking"), or other temporary storage services provided by pipeline transporters, whether actual or provided as a matter of accounting. Temporary storage is limited to 30 days or less; and

(9) *Supplemental costs for compression, dehydration, and treatment of gas.* MMS allows these costs only if such services are required for transportation and exceed the services necessary to place production into marketable condition required under §§ 206.152(i) and 206.153(i) of this part.

(g) *Nonallowable costs in determining transportation allowances.* Lessees may not include the following costs in determining the arm's-length transportation allowance under paragraph (a) of this section or the non-arm's-length transportation allowance under paragraph (b) of this section:

(1) *Fees or costs incurred for storage.* This includes storing production in a storage facility, whether on or off the lease, for more than 30 days;

(2) *Aggregator/marketer fees.* This includes fees you pay to another person (including your affiliates) to market your gas, including purchasing and reselling the gas, or finding or maintaining a market for the gas production;

(3) *Penalties you incur as shipper.* These penalties include, but are not limited to:

(i) *Over-delivery cash-out penalties.* This includes the difference between the price the pipeline pays you for over-delivered volumes outside the tolerances and the price you receive for over-delivered volumes within the tolerances;

(ii) *Scheduling penalties.* This includes penalties you incur for differences between daily volumes delivered into the pipeline and volumes scheduled or nominated at a receipt or delivery point;

(iii) *Imbalance penalties.* This includes penalties you incur (generally on a monthly basis) for differences between volumes delivered into the pipeline and volumes scheduled or nominated at a receipt or delivery point; and

(iv) *Operational penalties.* This includes fees you incur for violation of the pipeline's curtailment or operational orders issued to protect the operational integrity of the pipeline;

(4) *Intra-hub transfer fees.* These are fees you pay to hub operators for administrative services (e.g., title transfer tracking) necessary to account for the sale of gas within a hub; and

(5) *Other nonallowable costs.* Any cost you incur for services you are required to provide at no cost to the lessor.

(h) *Other transportation cost determinations.* Use this section when calculating transportation costs to establish value using a netback procedure or any other

procedure that requires deduction of transportation costs.

[53 FR 1272, Jan. 15, 1988, as amended at 53 FR 45762, Nov. 14, 1988; 61 FR 5465, Feb. 12, 1996; 62 FR 65762, Dec. 16, 1997]

§ 206.158 Processing allowances—general.

(a) Where the value of gas is determined pursuant to § 206.153 of this subpart, a deduction shall be allowed for the reasonable actual costs of processing.

(b) Processing costs must be allocated among the gas plant products. A separate processing allowance must be determined for each gas plant product and processing plant relationship. Natural gas liquids (NGL's) shall be considered as one product.

(c)(1) Except as provided in paragraph (d)(2) of this section, the processing allowance shall not be applied against the value of the residue gas. Where there is no residue gas MMS may designate an appropriate gas plant product against which no allowance may be applied.

(2) Except as provided in paragraph (c)(3) of this section, the processing allowance deduction on the basis of an individual product shall not exceed 66% percent of the value of each gas plant product determined in accordance with § 206.153 of this subpart (such value to be reduced first for any transportation allowances related to postprocessing transportation authorized by § 206.156 of this subpart).

(3) Upon request of a lessee, MMS may approve a processing allowance in excess of the limitation prescribed by paragraph (c)(2) of this section. The lessee must demonstrate that the processing costs incurred in excess of the limitation prescribed in paragraph (c)(2) of this section were reasonable, actual, and necessary. An application for exception (using Form MMS-4393, Request to Exceed Regulatory Allowance Limitation) shall contain all relevant and supporting documentation for MMS to make a determination. Under no circumstances shall the value for royalty purposes of any gas plant product be reduced to zero.

(d)(1) Except as provided in paragraph (d)(2) of this section, no processing cost deduction shall be allowed

for the costs of placing lease products in marketable condition, including dehydration, separation, compression, or storage, even if those functions are performed off the lease or at a processing plant. Where gas is processed for the removal of acid gases, commonly referred to as "sweetening," no processing cost deduction shall be allowed for such costs unless the acid gases removed are further processed into a gas plant product. In such event, the lessee shall be eligible for a processing allowance as determined in accordance with this subpart. However, MMS will not grant any processing allowance for processing lease production which is not royalty bearing.

(2)(i) If the lessee incurs extraordinary costs for processing gas production from a gas production operation, it may apply to MMS for an allowance for those costs which shall be in addition to any other processing allowance to which the lessee is entitled pursuant to this section. Such an allowance may be granted only if the lessee can demonstrate that the costs are, by reference to standard industry conditions and practice, extraordinary, unusual, or unconventional.

(ii) Prior MMS approval to continue an extraordinary processing cost allowance is not required. However, to retain the authority to deduct the allowance the lessee must report the deduction to MMS in a form and manner prescribed by MMS.

(e) If MMS determines that a lessee has improperly determined a processing allowance authorized by this subpart, then the lessee shall pay any additional royalties, plus interest determined in accordance with 30 CFR 218.54, or shall be entitled to a credit, without interest. If the lessee takes a deduction for processing on the Form MMS-2014 by improperly netting the allowance against the sales value of the gas plant products instead of reporting the allowance as a separate line item, he may be assessed an additional amount under 206.159(d).

[53 FR 1272, Jan. 15, 1988, as amended at 61 FR 5466, Feb. 12, 1996; 64 FR 23288, Aug. 10, 1999]

§ 206.159 Determination of processing allowances.

(a) *Arm's-length processing contracts.* (1)(C) For processing costs incurred by a lessee under an arm's-length contract, the processing allowance shall be the reasonable actual costs incurred by the lessee for processing the gas under that contract, except as provided in paragraphs (a)(1)(ii) and (a)(1)(iii) of this section, subject to monitoring, review, audit, and adjustment. The lessee shall have the burden of demonstrating that its contract is arm's-length. MMS' prior approval is not required before a lessee may deduct costs incurred under an arm's-length contract. The lessee must claim a processing allowance by reporting it as a separate line entry on the Form MMS-2014.

(ii) In conducting reviews and audits, MMS will examine whether the contract reflects more than the consideration actually transferred either directly or indirectly from the lessee to the processor for the processing. If the contract reflects more than the total consideration, then the MMS may require that the processing allowance be determined in accordance with paragraph (b) of this section.

(iii) If MMS determines that the consideration paid pursuant to an arm's-length processing contract does not reflect the reasonable value of the processing because of misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and lessor, then MMS shall require that the processing allowance be determined in accordance with paragraph (b) of this section. When MMS determines that the value of the processing may be unreasonable, MMS will notify the lessee and give the lessee an opportunity to provide written information justifying the lessee's processing costs.

(2) If an arm's-length processing contract includes more than one gas plant product and the processing costs attributable to each product can be determined from the contract, then the processing costs for each gas plant product shall be determined in accordance with the contract. No allowance

may be taken for the costs of processing lease production which is not royalty-bearing.

(3) If an arm's-length processing contract includes more than one gas plant product and the processing costs attributable to each product cannot be determined from the contract, the lessee shall propose an allocation procedure to MMS. The lessee may use its proposed allocation procedure until MMS issues its determination. The lessee shall submit all relevant data to support its proposal. MMS shall then determine the processing allowance based upon the lessee's proposal and any additional information MMS deems necessary. No processing allowance will be granted for the costs of processing lease production which is not royalty bearing. The lessee must submit the allocation proposal within 3 months of claiming the allocated deduction on Form MMS-2014.

(4) Where the lessee's payments for processing under an arm's-length contract are not based on a dollar per unit basis, the lessee shall convert whatever consideration is paid to a dollar value equivalent for the purposes of this section.

(b) *Non-arm's-length or no contract.* (1) If a lessee has a non-arm's-length processing contract or has no contract, including those situations where the lessee performs processing for itself, the processing allowance will be based upon the lessee's reasonable actual costs as provided in this paragraph. All processing allowances deducted under a non-arm's-length or no-contract situation are subject to monitoring, review, audit, and adjustment. The lessee must claim a processing allowance by reflecting it as a separate line entry on the Form MMS-2014. When necessary or appropriate, MMS may direct a lessee to modify its estimated or actual processing allowance.

(2) The processing allowance for non-arm's-length or no-contract situations shall be based upon the lessee's actual costs for processing during the reporting period, including operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment in accordance with paragraph (b)(2)(iv)(A) of this section, or a cost equal to the

initial depreciable investment in the processing plant multiplied by a rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those costs for depreciable fixed assets (including costs of delivery and installation of capital equipment) which are an integral part of the processing plant.

(i) Allowable operating expenses include: Operations supervision and engineering; operations labor; fuel; utilities; materials; ad valorem property taxes; rent; supplies; and any other directly allocable and attributable operating expense which the lessee can document.

(ii) Allowable maintenance expenses include: Maintenance of the processing plant; maintenance of equipment; maintenance labor; and other directly allocable and attributable maintenance expenses which the lessee can document.

(iii) Overhead directly attributable and allocable to the operation and maintenance of the processing plant is an allowable expense. State and Federal income taxes and severance taxes, including royalties, are not allowable expenses.

(iv) A lessee may use either depreciation or a return on depreciable capital investment. When a lessee has elected to use either method for a processing plant, the lessee may not later elect to change to the other alternative without approval of the MMS.

(A) To compute depreciation, the lessee may elect to use either a straight-line depreciation method based on the life of equipment or on the life of the reserves which the processing plant services, or a unit-of-production method. After an election is made, the lessee may not change methods without MMS approval. A change in ownership of a processing plant shall not alter the depreciation schedule established by the original processor/lessee for purposes of the allowance calculation. With or without a change in ownership, a processing plant shall be depreciated only once. Equipment shall not be depreciated below a reasonable salvage value.

(B) The MMS shall allow as a cost an amount equal to the allowable initial capital investment in the processing

plant multiplied by the rate of return determined pursuant to paragraph (b)(2)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to plants first placed in service after March 1, 1988.

(v) The rate of return must be the industrial rate associated with Standard and Poor's BBB rating. The rate of return must be the monthly average rate as published in Standard and Poor's Bond Guide for the first month for which the allowance is applicable. The rate must be redetermined at the beginning of each subsequent calendar year.

(3) The processing allowance for each gas plant product shall be determined based on the lessee's reasonable and actual cost of processing the gas. Allocation of costs to each gas plant product shall be based upon generally accepted accounting principles. The lessee may not take an allowance for the costs of processing lease production which is not royalty bearing.

(4) A lessee may apply to MMS for an exception from the requirement that it compute actual costs in accordance with paragraphs (b)(1) through (b)(3) of this section. The MMS may grant the exception only if: (i) The lessee has arm's-length contracts for processing other gas production at the same processing plant; and (ii) at least 50 percent of the gas processed annually at the plant is processed pursuant to arm's-length processing contracts; if the MMS grants the exception, the lessee shall use as its processing allowance the volume weighted average prices charged other persons pursuant to arm's-length contracts for processing at the same plant.

(c) *Reporting requirements*—(1) *Arm's-length contracts*. (i) The lessee must notify MMS of an allowance based on incurred costs by using a separate line entry on the Form MMS-2014.

(ii) The MMS may require that a lessee submit arm's-length processing contracts and related documents. Documents shall be submitted within a reasonable time, as determined by MMS.

(2) *Non-arm's-length or no contract*. (i) The lessee must notify MMS of an allowance based on the incurred costs by

using a separate line entry on the Form MMS-2014.

(ii) For new processing plants, the lessee's initial deduction shall include estimates of the allowable gas processing costs for the applicable period. Cost estimates shall be based upon the most recently available operations data for the plant or, if such data are not available, the lessee shall use estimates based upon industry data for similar gas processing plants.

(iii) Upon request by MMS, the lessee shall submit all data used to prepare the allowance deduction. The data shall be provided within a reasonable period of time, as determined by MMS.

(iv) If the lessee is authorized to use the volume weighted average prices charged other persons as its processing allowance in accordance with paragraph (b)(4) of this section, it shall follow the reporting requirements of paragraph (c)(1) of this section.

(d) *Interest and assessments*. (1) If a lessee nets a processing allowance against the royalty value on the Form MMS-2014, the lessee shall be assessed an amount of up to 10 percent of the allowance netted not to exceed \$250 per lease selling arrangement per sales period.

(2) If a lessee deducts a processing allowance on its Form MMS-2014 that exceeds 66⅔ percent of the value of the gas processed without obtaining prior approval of MMS under § 206.158, the lessee shall pay interest on the excess allowance amount taken from the date such amount is taken to the date the lessee files an exception request with MMS.

(3) If a lessee erroneously reports a processing allowance which results in an underpayment of royalties, interest shall be paid on the amount of that underpayment.

(4) Interest required to be paid by this section shall be determined in accordance with 30 CFR 218.54.

(e) *Adjustments*. (1) If the actual processing allowance is less than the amount the lessee has taken on Form MMS 2014 for each month during the allowance reporting period, the lessee shall pay additional royalties due plus interest computed under 30 CFR 218.54 from the allowance reporting period when the lessee took the deduction to

the date the lessee repays the difference to MMS. If the actual processing allowance is greater than the amount the lessee has taken on Form MMS-2014 for each month during the allowance reporting period, the lessee shall be entitled to a credit without interest.

(2) For lessees processing production from onshore Federal leases, the lessee must submit a corrected Form MMS-2014 to reflect actual costs, together with any payment, in accordance with instructions provided by MMS.

(3) For lessees processing gas production from leases on the OCS, if the lessee's estimated processing allowance exceeds the allowance based on actual costs, the lessee must submit a corrected Form MMS-2014 to reflect actual costs together with its payment, in accordance with instructions provided by MMS. If the lessee's estimated costs were less than the actual costs, the refund procedure will be specified by MMS.

(f) *Other processing cost determinations*. The provisions of this section shall apply to determine processing costs when establishing value using a net back valuation procedure or any other procedure that requires deduction of processing costs.

[53 FR 1272, Jan. 15, 1988, as amended at 53 FR 45762, Nov. 14, 1988; 61 FR 5466, Feb. 12, 1996; 64 FR 43288, Aug. 10, 1999]

§ 206.160 Operating allowances.

Notwithstanding any other provisions in these regulations, an operating allowance may be used for the purpose of computing payment obligations when specified in the notice of sale and the lease. The allowance amount or formula shall be specified in the notice of sale and in the lease agreement.

[61 FR 3804, Feb. 2, 1996]

Subpart E—Indian Gas

SOURCE: 64 FR 43515, Aug. 10, 1999, unless otherwise noted.

§ 206.170 What does this subpart contain?

This subpart contains royalty valuation provisions applicable to Indian lessees.

(a) This subpart applies to all gas production from Indian (tribal and allotted) oil and gas leases (except leases on the Osage Indian Reservation). The purpose of this subpart is to establish the value of production for royalty purposes consistent with the mineral leasing laws, other applicable laws, and lease terms. This subpart does not apply to Federal leases.

(b) If the specific provisions of any Federal statute, treaty, negotiated agreement, settlement agreement resulting from any administrative or judicial proceeding, or Indian oil and gas lease are inconsistent with any regulation in this subpart, then the Federal statute, treaty, negotiated agreement, settlement agreement, or lease will govern to the extent of that inconsistency.

(c) You may calculate the value of production for royalty purposes under methods other than those the regulations in this title require, but only if you, the tribal lessor, and MMS jointly agree to the valuation methodology. For leases on Indian allotted lands, you and MMS must agree to the valuation methodology.

(d) All royalty payments you make to MMS are subject to monitoring, review, audit, and adjustment.

(e) The regulations in this subpart are intended to ensure that the trust responsibilities of the United States with respect to the administration of Indian oil and gas leases are discharged in accordance with the requirements of the governing mineral leasing laws, treaties, and lease terms.

§ 206.171 What definitions apply to this subpart?

The following definitions apply to this subpart and to subpart J of part 202 of this title:

Accounting for comparison means the same as dual accounting.

Active spot market means a market where one or more MMS-acceptable publications publish bidweek prices (or if bidweek prices are not available, first of the month prices) for at least one index-pricing point in the index zone.

Allowance means a deduction in determining value for royalty purposes.

particular index zone. Any change to the index zones will be published in the FEDERAL REGISTER. MMS will consider the following five factors and conditions in determining eligible index zones:

(i) Areas for which MMS-approved publications establish index prices that accurately reflect the value of production in the field or area where the production occurs;

(ii) Common markets served;

(iii) Common pipeline systems;

(iv) Simplification; and

(v) Easy identification in MMS's systems, such as counties or Indian reservations.

(3) If market conditions change so that an index-based method for determining value is no longer appropriate for an index zone, MMS will hold a technical conference to consider disqualification of an index zone. MMS will publish notice in the FEDERAL REGISTER if an index zone is disqualified. If an index zone is disqualified, then production from leases in that index zone cannot be valued under this paragraph.

(4) MMS periodically will publish in the FEDERAL REGISTER a list of acceptable publications based on certain criteria, including, but not limited to the following five criteria:

(i) Publications buyers and sellers frequently use;

(ii) Publications frequently referenced in purchase or sales contracts;

(iii) Publications that use adequate survey techniques, including the gathering of information from a substantial number of sales;

(iv) Publications that publish the range of reported prices they use to calculate their index; and

(v) Publications independent from DOI, lessors, and lessees.

(5) Any publication may petition MMS to be added to the list of acceptable publications.

(6) MMS may exclude an individual index price for an index zone in an MMS-approved publication if MMS determines that the index price does not accurately reflect the value of production in that index zone. MMS will publish a list of excluded indices in the FEDERAL REGISTER.

(7) MMS will reference which tables in the publications you must use for determining the associated index prices.

(8) The index-based values determined under this paragraph are not subject to deductions for transportation or processing allowances determined under §§ 206.177, 206.178, 206.179, and 206.180.

(e) *Determining the minimum value for royalty purposes of gas sold beyond the first index pricing point.* (1) Notwithstanding any other provision of this section, the value for royalty purposes of gas production from an Indian lease that is sold beyond the first index pricing point through which it flows cannot be less than the value determined under this paragraph (e).

(2) By June 30 following any calendar year, you must calculate for each month of that calendar year your safety net price per MMBtu using the procedures in paragraph (e)(3) of this section. You must calculate a safety net price for each month and for each index zone where you have an Indian lease for which you report and pay royalties.

(3) Your safety net price (S) for an index zone is the volume-weighted average contract price per delivered MMBtu under your or your affiliate's arm's-length contracts for the disposition of residue gas or unprocessed gas produced from your Indian leases in that index zone as computed under this paragraph (e)(3).

(i) Include in your calculation only sales under those contracts that establish a delivery point beyond the first index pricing point through which the gas flows, and that include any gas produced from or allocable to one or more of your Indian leases in that index zone, even if the contract also includes gas produced from Federal, State, or fee properties. Include in your volume-weighted average calculation those volumes that are allocable to your Indian leases in that index zone.

(ii) Do not reduce the contract price for any transportation costs incurred to deliver the gas to the purchaser.

(iii) For purposes of this paragraph (e), the contract price will not include the following amounts:

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(A) Any amounts you receive in compromise or settlement of a predecessor contract for that gas;

(B) Deductions for you or any other person to put gas production into marketable condition or to market the gas; and

(C) Any amounts related to marketable securities associated with the sales contract.

(4) Next, you must determine for each month the safety net differential (SND). You must perform this calculation separately for each index zone.

(i) For each index zone, the safety net differential is equal to: $SND = [(0.80 \times S) - (1.25 \times I)]$ where (I) is the index-based value determined under 30 CFR 206.172(d).

(ii) If the safety net differential is positive you owe additional royalties.

(5)(i) To calculate the additional royalties you owe, make the following calculation for each of your Indian leases in that index zone that produced gas that was sold beyond the first index-pricing point through which the gas flowed and that was used in the calculation in paragraph (e)(3) of this section:

Lease royalties owed = $SND \times V \times R$, where R = the lease royalty rate and V = the volume allocable to the lease which produced gas that was sold beyond the first index pricing point.

(ii) If gas produced from any of your Indian leases is commingled or pooled with gas produced from non-Indian properties, and if any of the combined gas is sold at a delivery point beyond the first index pricing point through which the gas flows, then the volume allocable to each Indian lease for which gas was sold beyond the first index pricing point in the calculation under paragraph (e)(5)(i) of this section is the volume produced from the lease multiplied by the proportion that the total volume of gas sold beyond the first index pricing point bears to the total volume of gas commingled or pooled from all properties.

(iii) Add the numbers calculated for each lease under paragraph (e)(5)(i) of this section. The total is the additional royalty you owe.

(6) You have the following responsibilities to comply with the minimum value for royalty purposes:

(i) You must report the safety net price for each index zone to MMS on Form MMS 4411, Safety Net Report, no later than June 30 following each calendar year;

(ii) You must pay and report on Form MMS-2014 additional royalties due no later than June 30 following each calendar year; and

(iii) MMS may order you to amend your safety net price within one year from the date your Form MMS-4411 is due or is filed, whichever is later. If MMS does not order any amendments within that one-year period, your safety net price calculation is final.

(f) *Excluding some or all tribal leases from valuation under this section.* (1) An Indian tribe may ask MMS to exclude some or all of its leases from valuation under this section. MMS will consult with BIA regarding the request.

(i) If MMS approves the request for your lease, you must value your production under § 206.174 beginning with production on the first day of the second month following the date MMS publishes notice of its decision in the FEDERAL REGISTER.

(ii) If an Indian tribe requests exclusion from an index zone for less than all of its leases, MMS will approve the request only if the excluded leases may be segregated into one or more groups based on separate fields within the reservation.

(2) An Indian tribe may ask MMS to terminate exclusion of its leases from valuation under this section. MMS will consult with BIA regarding the request.

(i) If MMS approves the request, you must value your production under § 206.172 beginning with production on the first day of the second month following the date MMS publishes notice of its decision in the FEDERAL REGISTER.

(ii) Termination of an exclusion under paragraph (f)(2)(i) of this section cannot take effect earlier than 1 year after the first day of the production month that the exclusion was effective.

(3) The Indian tribe's request to MMS under either paragraph (f)(1) or (2) of this section must be in the form of a tribal resolution.

(g) *Excluding Indian allotted leases from valuation under this section.* (1)(i)

MMS may exclude any Indian allotted leases from valuation under this section. MMS will consult with BIA regarding the exclusion.

(ii) If MMS excludes your lease, you must value your production under §206.174 beginning with production on the first day of the second month following the date MMS publishes notice of its decision in the FEDERAL REGISTER.

(iii) If MMS excludes any Indian allotted leases under this paragraph (g)(1), it will exclude all Indian allotted leases in the same field.

(2)(i) MMS may terminate the exclusion of any Indian allotted leases from valuation under this section. MMS will consult with BIA regarding the termination.

(ii) If MMS terminates the exclusion, you must value your production under §206.172 beginning with production on the first day of the second month following the date MMS publishes notice of its decision in the FEDERAL REGISTER.

§206.173 How do I calculate the alternative methodology for dual accounting?

(a) *Electing a dual accounting method.*
(1) If you are required to perform the accounting for comparison (dual accounting) under §206.176, you have two choices. You may elect to perform the dual accounting calculation according to either §206.176(a) (called actual dual accounting), or paragraph (b) of this section (called the alternative methodology for dual accounting).

(2) You must make a separate election to use the alternative methodology for dual accounting for your Indian leases in each MMS-designated area. Your election for a designated area must apply to all of your Indian leases in that area.

(i) MMS will publish in the FEDERAL REGISTER a list of the lease prefixes that will be associated with each designated area for purposes of this section. The MMS-designated areas are as follows:

- (A) Alabama-Coushatta;
- (B) Blackfeet Reservation;
- (C) Crow Reservation;
- (D) Fort Belknap Reservation;
- (E) Fort Berthold Reservation;

- (F) Fort Peck Reservation;
- (G) Jicarilla Apache Reservation;
- (H) MMS-designated groups of counties in the State of Oklahoma;
- (I) Navajo Reservation;
- (J) Northern Cheyenne Reservation;
- (K) Rocky Boys Reservation;
- (L) Southern Ute Reservation;
- (M) Turtle Mountain Reservation;
- (N) Ute Mountain Ute Reservation;
- (O) Uintah and Ouray Reservation;
- (P) Wind River Reservation; and
- (Q) Any other area that MMS designates. MMS will publish a new area designation in the FEDERAL REGISTER.

(ii) You may elect to begin using the alternative methodology for dual accounting at the beginning of any month. The first election to use the alternative methodology will be effective from the time of election through the end of the following calendar year. Thereafter, each election to use the alternative methodology must remain in effect for 2 calendar years. You may return to the actual dual accounting method only at the beginning of the next election period or with the written approval of MMS and the tribal lessor for tribal leases, and MMS for Indian allottee leases in the designated area.

(iii) When you elect to use the alternative methodology for a designated area, you must also use the alternative methodology for any new wells commenced and any new leases acquired in the designated area during the term of the election.

(b) *Calculating value using the alternative methodology for dual accounting.*

(i) The alternative methodology adjusts the value of gas before processing determined under either §206.172 or §206.174 to provide the value of the gas after processing. You must use the value of the gas after processing for royalty payment purposes. The amount of the increase depends on your relationship with the owner(s) of the plant where the gas is processed. If you have no direct or indirect ownership interest in the processing plant, then the increase is lower, as provided in the table in paragraph (b)(2)(ii) of this section. If you have a direct or indirect ownership interest in the plant where the gas is processed, the increase is higher, as

provided in paragraph (b)(2)(ii) of this section.

(2) To calculate the value of the gas after processing using the alternative methodology for dual accounting, you must apply the increase to the value before processing, determined in either §206.172 or §206.174, as follows:

(i) Value of gas after processing = (value determined under either §206.172 or §206.174, as applicable) × (1 + increment for dual accounting); and

(ii) In this equation, the increment for dual accounting is the number you take from the applicable Btu range, determined under paragraph (b)(3) of this section, in the following table:

Btu range	Increment if Lessee has no ownership interest in plant	Increment if Lessee has an ownership interest in plant
1001 to 1050	.0275	.0375
1051 to 1100	.0400	.0625
1101 to 1150	.0425	.0750
1151 to 1200	.0700	.1225
1201 to 1250	.0975	.1700
1251 to 1300	.1175	.2050
1301 to 1350	.1400	.2400
1351 to 1400	.1450	.2500
1401 to 1450	.1500	.2600
1451 to 1500	.1550	.2700
1501 to 1550	.1600	.2800
1551 to 1600	.1650	.2900
1601 to 1650	.1850	.3225
1651 to 1700	.1950	.3425
1701+	.2000	.3550

(3) The applicable Btu for purposes of this section is the volume weighted-average Btu for the lease computed from measurements at the facility measurement point(s) for gas production from the lease.

(4) If any of your gas from the lease is processed during a month, use the following two paragraphs to determine which amounts are subject to dual accounting and which dual accounting method you must use.

(i) Weighted-average Btu content determined under paragraph (b)(3) of this section is greater than 1,000 Btu's per cubic foot (Btu/cf). All gas production from the lease is subject to dual accounting and you must use the alternative method for all that gas production if you elected to use the alternative method under this section.

(ii) Weighted-average Btu content determined under paragraph (b)(3) of this section is less than or equal to 1,000 Btu/cf. Only the volumes of lease pro-

duction measured at facility measurement points whose quality exceeds 1,000 Btu/cf are subject to dual accounting, and you may use the alternative methodology for these volumes. For gas measured at facility measurement points for these leases where the quality is equal to or less than 1,000 Btu/cf, you are not required to do dual accounting.

§206.174 How do I value gas production when an index-based method cannot be used?

(a) *Situations in which an index-based method cannot be used.* (1) Gas production must be valued under this section in the following situations.

(i) Your lease is not in an index zone (or MMS has excluded your lease from an index zone).

(ii) If your lease is in an index zone and you sell your gas under an arm's-length dedicated contract, then the value of your gas is the higher of the value received under the dedicated contract determined under §206.174(b) or the value under §206.172.

(iii) Also use this section to value any other gas production that cannot be valued under §206.172, as well as gas plant products, and to value components of the gas stream that have no Btu value (for example, carbon dioxide, nitrogen, etc.).

(2) The value for royalty purposes of gas production subject to this subpart is the value of gas determined under this section less applicable allowances determined under this subpart.

(3) You must determine the value of gas production that is processed and is subject to accounting for comparison using the procedure in §206.176.

(4) This paragraph applies if your lease has a major portion provision. It also applies if your lease does not have a major portion provision but the lease provides for the Secretary to determine value.

(i) The value of production you must initially report and pay is the value determined in accordance with the other paragraphs of this section.

(ii) MMS will determine the major portion value and notify you in the FEDERAL REGISTER of that value. The

value of production for royalty purposes for your lease is the higher of either the value determined under this section which you initially used to report and pay royalties, or the major portion value calculated under this paragraph (a)(4). If the major portion value is higher, you must submit an amended Form MMS-2014 to MMS by the due date specified in the written notice from MMS of the major portion value. Late-payment interest under 30 CFR 218.54 on any underpayment will not begin to accrue until the date the amended Form MMS-2014 is due to MMS.

(iii) Except as provided in paragraph (a)(4)(iv) of this section, MMS will calculate the major portion value for each designated area (which are the same designated areas as under § 206.173) using values reported for unprocessed gas and residue gas on Form MMS-2014 for gas produced from leases on that Indian reservation or other designated area. MMS will array the reported prices from highest to lowest price. The major portion value is that price at which 25 percent (by volume) of the gas (starting from the highest) is sold. MMS cannot unilaterally change the major portion value after you are notified in writing of what that value is for your leases.

(iv) MMS may calculate the major portion value using different data than the data described in paragraph (a)(4)(iii) of this section or data to augment the data described in paragraph (a)(4)(iii) of this section. This may include price data reported to the State tax authority or price data from leases MMS has reviewed in the designated area. MMS may use this alternate or the augmented data source beginning with production on the first day of the month following the date MMS publishes notice in the FEDERAL REGISTER that it is calculating the major portion using a method in this paragraph (a)(4)(iv) of this section.

(b) *Arm's-length contracts.* (1) The value of gas, residue gas, or any gas plant product you sell under an arm's-length contract is the gross proceeds accruing to you or your affiliate, except as provided in paragraphs (b)(1)(ii)-(iv) of this section.

(i) You have the burden of demonstrating that your contract is arm's-length.

(ii) In conducting reviews and audits for gas valued based upon gross proceeds under this paragraph, MMS will examine whether or not your contract reflects the total consideration actually transferred either directly or indirectly from the buyer to you or your affiliate for the gas, residue gas, or gas plant product. If the contract does not reflect the total consideration, then MMS may require that the gas, residue gas, or gas plant product sold under that contract be valued in accordance with paragraph (c) of this section. Value may not be less than the gross proceeds accruing to you or your affiliate, including the additional consideration.

(iii) If MMS determines for gas valued under this paragraph that the gross proceeds accruing to you or your affiliate under an arm's-length contract do not reflect the value of the gas, residue gas, or gas plant products because of misconduct by or between the contracting parties, or because you otherwise have breached your duty to the lessor to market the production for the mutual benefit of you and the lessor, then MMS will require that the gas, residue gas, or gas plant product be valued under paragraphs (c)(2) or (3) of this section. In these circumstances, MMS will notify you and give you an opportunity to provide written information justifying your value.

(iv) This paragraph applies to situations where a pipeline purchases gas from a lessee according to a cash-out program under a transportation contract. For all over-delivered volumes, the royalty value is the price the pipeline is required to pay for volumes within the tolerances for over-delivery specified in the transportation contract. Use the same value for volumes that exceed the over-delivery tolerances even if those volumes are subject to a lower price specified in the transportation contract. However, if MMS determines that the price specified in the transportation contract for over-delivered volumes is unreasonably low, the lessees must value all over-delivered volumes under paragraph (c)(2) or (3) of this section.

(2) MMS may require you to certify that your arm's-length contract provisions include all of the consideration the buyer pays, either directly or indirectly, for the gas, residue gas, or gas plant product.

(c) *Non-arm's-length contracts.* If your gas, residue gas, or any gas plant product is not sold under an arm's-length contract, then you must value the production using the first applicable method of the following three methods:

(1) The gross proceeds accruing to you under your non arm's-length contract sale (or other disposition other than by an arm's-length contract), provided that those gross proceeds are equivalent to the gross proceeds derived from, or paid under, comparable arm's-length contracts for purchases, sales, or other dispositions of like-quality gas in the same field (or, if necessary to obtain a reasonable sample, from the same area). For residue gas or gas plant products, the comparable arm's-length contracts must be for gas from the same processing plant (or, if necessary to obtain a reasonable sample, from nearby plants). In evaluating the comparability of arm's-length contracts for the purposes of these regulations, the following factors will be considered: price, time of execution, duration, market or markets served, terms, quality of gas, residue gas, or gas plant products, volume, and such other factors as may be appropriate to reflect the value of the gas, residue gas, or gas plant products.

(2) A value determined by consideration of other information relevant in valuing like-quality gas, residue gas, or gas plant products, including gross proceeds under arm's-length contracts for like-quality gas in the same field or nearby fields or areas, or for residue gas or gas plant products from the same gas plant or other nearby processing plants. Other factors to consider include prices received in spot sales of gas, residue gas or gas plant products, other reliable public sources of price or market information, and other information as to the particular lease operation or the salability of such gas, residue gas, or gas plant products.

(3) A net-back method or any other reasonable method to determine value.

(d) *Supporting data.* If you determine the value of production under paragraph (c) of this section, you must retain all data relevant to the determination of royalty value.

(1) Such data will be subject to review and audit, and MMS will direct you to use a different value if we determine upon review or audit that the value you reported is inconsistent with the requirements of these regulations.

(2) You must make all such data available upon request to the authorized MMS or Indian representatives, to the Office of the Inspector General of the Department, or other authorized persons. This includes your arm's-length sales and volume data for like-quality gas, residue gas, and gas plant products that are sold, purchased, or otherwise obtained from the same processing plant or from nearby processing plants, or from the same or nearby field or area.

(e) *Improper values.* If MMS determines that you have not properly determined value, you must pay the difference, if any, between royalty payments made based upon the value you used and the royalty payments that are due based upon the value MMS established. You also must pay interest computed on that difference under 30 CFR 218.54. If you are entitled to a credit, MMS will provide instructions on how to take that credit.

(f) *Value guidance.* You may ask MMS for guidance in determining value. You may propose a valuation method to MMS. Submit all available data related to your proposal and any additional information MMS deems necessary. MMS will promptly review your proposal and provide you with a non-binding determination of the guidance you request.

(g) *Minimum value of production.* (1) For gas, residue gas, and gas plant products valued under this section, under no circumstances may the value of production for royalty purposes be less than the gross proceeds accruing to the lessee (including its affiliates) for gas, residue gas and/or any gas plant products, less applicable transportation allowances and processing allowances determined under this subpart.

(2) For gas plant products valued under this section and not valued

you must convert whatever consideration is paid to a dollar value equivalent for the purposes of this section.

(5) Where an arm's-length sales contract price includes a reduction for a transportation factor, MMS will not consider the transportation factor to be a transportation allowance. You may use the transportation factor to determine your gross proceeds for the sale of the product. However, the transportation factor may not exceed 50 percent of the base price of the product without MMS approval.

(b) *Determining a transportation allowance under a non-arm's-length or no contract.* (i) This paragraph explains how to determine your allowance if you have a non-arm's-length transportation contract or no contract.

(i) When you have a non-arm's-length transportation contract or no contract, including those situations where you perform transportation services for yourself, the transportation allowance is based upon your reasonable, allowable, actual costs for transportation as provided in this paragraph.

(ii) All transportation allowances deducted under a non-arm's-length or no contract situation are subject to monitoring, review, audit, and adjustment. You must submit the actual cost information to support the allowance to MMS on Form MMS-4295, Gas Transportation Allowance Report, within 3 months after the end of the 12-month period to which the allowance applies. However, MMS may approve a longer time period. MMS will monitor the allowance deductions to ensure that deductions are reasonable and allowable. When necessary or appropriate, MMS may require you to modify your actual transportation allowance deduction.

(2) This paragraph explains what actual transportation costs are allowable under a non-arm's-length contract or no contract situation. The transportation allowance for non-arm's-length or no-contract situations is based upon your actual costs for transportation during the reporting period. Allowable costs include operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment (in accordance with paragraph (b)(2)(iv)(A) of this section), or a cost equal to the

initial depreciable investment in the transportation system multiplied by a rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those costs for depreciable fixed assets (including costs of delivery and installation of capital equipment) that are an integral part of the transportation system.

(i) Allowable operating expenses include operations supervision and engineering, operations labor, fuel, utilities, materials, ad valorem property taxes, rent, supplies, and any other directly allocable and attributable operating expense that you can document.

(ii) Allowable maintenance expenses include maintenance of the transportation system, maintenance of equipment, maintenance labor, and other directly allocable and attributable maintenance expenses that you can document.

(iii) Overhead directly attributable and allocable to the operation and maintenance of the transportation system is an allowable expense. State and Federal income taxes and severance taxes and other fees, including royalties, are not allowable expenses.

(iv) You may use either depreciation with a return on undepreciated capital investment or a return on depreciable capital investment. After you have elected to use either method for a transportation system, you may not later elect to change to the other alternative without MMS approval.

(A) To compute depreciation, you may elect to use either a straight-line depreciation method based on the life of equipment or on the life of the reserves that the transportation system services, or a unit of production method. Once you make an election, you may not change methods without MMS approval. A change in ownership of a transportation system will not alter the depreciation schedule that the original transporter/lessee established for purposes of the allowance calculation. With or without a change in ownership, a transportation system may be depreciated only once. Equipment may not be depreciated below a reasonable salvage value. To compute a return on undepreciated capital investment, you will multiply the undepreciated capital

investment in the transportation system by the rate of return determined under paragraph (b)(2)(v) of this section.

(B) To compute a return on depreciable capital investment, you will multiply the initial capital investment in the transportation system by the rate of return determined under paragraph (b)(2)(v) of this section. No allowance will be provided for depreciation. This alternative will apply only to transportation facilities first placed in service after March 1, 1988.

(v) The rate of return is the industrial rate associated with Standard and Poor's BBB rating. The rate of return is the monthly average rate as published in *Standard and Poor's Bond Guide* for the first month of the reporting period for which the allowance is applicable and is effective during the reporting period. The rate must be re-determined at the beginning of each subsequent transportation allowance reporting period that is determined under paragraph (b)(4) of this section.

(3) This paragraph explains how to allocate transportation costs to each product and transportation system.

(i) The deduction for transportation costs must be determined based on your cost of transporting each product through each individual transportation system. If you transport more than one product in a gaseous phase, the allocation of costs to each of the products transported must be made in a consistent and equitable manner. The allocation should be in the same proportion that the volume of each product (excluding waste products that have no value) bears to the volume of all products in the gaseous phase (excluding waste products that have no value). Except as provided in this paragraph, you may not take an allowance for transporting a product that is not royalty bearing without MMS approval.

(ii) As an alternative to the requirements of paragraph (b)(3)(i) of this section, you may propose to MMS a cost allocation method based on the values of the products transported. MMS will approve the method upon determining that it meets one of the two following requirements:

(A) The methodology in paragraph (b)(3)(i) of this section cannot be applied; and

(B) Your proposal is more reasonable than the method in paragraph (b)(3)(i) of this section.

(4) Your transportation allowance under this paragraph (b) must be determined based upon a calendar year or other period if you and MMS agree to an alternative.

(5) If you transport both gaseous and liquid products through the same transportation system, you must propose a cost allocation procedure to MMS. You may use the transportation allowance determined in accordance with your proposed allocation procedure until MMS issues its determination on the acceptability of the cost allocation. You are required to submit all relevant data to support your proposal. MMS will then determine the transportation allowance based upon your proposal and any additional information MMS deems necessary.

(c) *Using the alternative transportation calculation when you have a non-arm's-length or no contract.* (1) As an alternative to computing your transportation allowance under paragraph (b) of this section, you may use as the transportation allowance 10 percent of your gross proceeds but not to exceed 30 cents per MMBtu.

(2) Your election to use the alternative transportation allowance calculation in paragraph (c)(1) of this section must be made at the beginning of a month and must remain in effect for an entire calendar year. Your first election will remain in effect until the end of the succeeding calendar year, except for elections effective January 1 that will be effective only for that calendar year.

(d) *Reporting your transportation allowance.* (1) If MMS requests, you must submit all data used to determine your transportation allowance. The data must be provided within a reasonable period of time that MMS will determine.

(2) You must report transportation allowances as a separate line item on Form MMS-2014. MMS may approve a different reporting procedure on allottee leases, and with lessor approval on tribal leases.

\$ 206.180 How do I determine an actual processing allowance?

(a) *Determining a processing allowance if you have an arm's-length processing contract.* (1) This paragraph explains how you determine an allowance under an arm's-length processing contract.

(i) The processing allowance is the reasonable actual costs you incur to process the gas under that contract. Paragraphs (a)(1)(ii) and (iii) of this section provide a limited exception. You have the burden of demonstrating that your contract is arm's-length. You are required to submit to MMS a copy of your arm's-length contract(s) and all subsequent amendments to the contract(s) within 2 months of the date MMS receives your first report that deducts the allowance on the Form MMS-2014.

(ii) When MMS conducts reviews and audits, we will examine whether the contract reflects more than the consideration actually transferred either directly or indirectly from you to the processor for the processing. If the contract reflects more than the total consideration, then MMS may require that the processing allowance be determined under paragraph (b) of this section.

(iii) If MMS determines that the consideration paid under an arm's-length processing contract does not reflect the value of the processing because of misconduct by or between the contracting parties, or because you otherwise have breached your duty to the lessor to market the production for the mutual benefit of you and the lessor, then MMS will require that the processing allowance be determined under paragraph (b) of this section. In these circumstances, MMS will notify you and give you an opportunity to provide written information justifying your processing costs.

(2) If your arm's-length processing contract includes more than one gas plant product and the processing costs attributable to each product can be determined from the contract, then the processing costs for each gas plant product must be determined in accordance with the contract. You may not take an allowance for the costs of processing lease production that is not royalty-bearing.

(3) If your arm's-length processing contract includes more than one gas plant product and the processing costs attributable to each product cannot be determined from the contract, you must propose an allocation procedure to MMS. You may use your proposed allocation procedure until MMS issues its determination. You are required to submit all relevant data to support your proposal. MMS will then determine the processing allowance based upon your proposal and any additional information MMS deems necessary. You may not take a processing allowance for the costs of processing lease production that is not royalty-bearing.

(4) If your payments for processing under an arm's-length contract are not based on a dollar per unit price, you must convert whatever consideration is paid to a dollar value equivalent for the purposes of this section.

(b) *Determining a processing allowance if you have a non-arm's-length contract or no contract.* (1) This paragraph applies if you have a non-arm's-length processing contract or no contract, including those situations where you perform processing for yourself.

(i) If you have a non-arm's-length contract or no contract, the processing allowance is based upon your reasonable actual costs of processing as provided in paragraph (b)(2) of this section.

(ii) All processing allowances deducted under a non-arm's-length or no-contract situation are subject to monitoring, review, audit, and adjustment. You must submit the actual cost information to support the allowance to MMS on Form MMS-4109, Gas Processing Allowance Summary Report, within 3 months after the end of the 12-month period for which the allowance applies. MMS may approve a longer time period. MMS will monitor the allowance deduction to ensure that deductions are reasonable and allowable. When necessary or appropriate, MMS may require you to modify your processing allowance.

(2) The processing allowance for non-arm's-length or no-contract situations is based upon your actual costs for processing during the reporting period. Allowable costs include operating and maintenance expenses, overhead, and

either depreciation and a return on undepreciated capital investment (in accordance with paragraph (b)(2)(iv)(A) of this section), or a cost equal to the initial depreciable investment in the processing plant multiplied by a rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those costs for depreciable fixed assets (including costs of delivery and installation of capital equipment) that are an integral part of the processing plant.

(i) Allowable operating expenses include operations supervision and engineering, operations labor, fuel, utilities, materials, ad valorem property taxes, rent, supplies, and any other directly allocable and attributable operating expense that the lessee can document.

(ii) Allowable maintenance expenses include maintenance of the processing plant, maintenance of equipment, maintenance labor, and other directly allocable and attributable maintenance expenses that you can document.

(iii) Overhead directly attributable and allocable to the operation and maintenance of the processing plant is an allowable expense. State and Federal income taxes and severance taxes, including royalties, are not allowable expenses.

(iv) You may use either depreciation with a return on undepreciable capital investment or a return on depreciable capital investment. After you elect to use either method for a processing plant, you may not later elect to change to the other alternative without MMS approval.

(A) To compute depreciation, you may elect to use either a straight-line depreciation method based on the life of equipment or on the life of the reserves that the processing plant services, or a unit-of-production method. Once you make an election, you may not change methods without MMS approval. A change in ownership of a processing plant will not alter the depreciation schedule that the original processor/lessee established for purposes of the allowance calculation. However, for processing plants you or your affiliate purchase that do not have a previously claimed MMS depreciation schedule, you may treat the

processing plant as a newly installed facility for depreciation purposes. A processing plant may be depreciated only once, regardless of whether there is a change in ownership. Equipment may not be depreciated below a reasonable salvage value. To compute a return on undepreciated capital investment, you must multiply the undepreciable capital investment in the processing plant by the rate of return determined under paragraph (b)(2)(v) of this section.

(B) To compute a return on depreciable capital investment, you must multiply the initial capital investment in the processing plant by the rate of return determined under paragraph (b)(2)(v) of this section. No allowance will be provided for depreciation. This alternative will apply only to plants first placed in service after March 1, 1988.

(v) The rate of return is the industrial rate associated with Standard and Poor's BBB rating. The rate of return is the monthly average rate as published in Standard and Poor's Bond Guide for the first month for which the allowance is applicable. The rate must be redetermined at the beginning of each subsequent calendar year.

(3) Your processing allowance under this paragraph (b) must be determined based upon a calendar year or other period if you and MMS agree to an alternative.

(4) The processing allowance for each gas plant product must be determined based on your reasonable and actual cost of processing the gas. You must base your allocation of costs to each gas plant product upon generally accepted accounting principles. You may not take an allowance for the costs of processing lease production that is not royalty-bearing.

(c) *Reporting your processing allowance.* (1) If MMS requests, you must submit all data used to determine your processing allowance. The data must be provided within a reasonable period of time, as MMS determines.

(2) You must report gas processing allowances as a separate line item on the Form MMS-2014. MMS may approve a different reporting procedure for allottee leases, and with lessor approval on tribal leases.

with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those costs for depreciable assets, including costs of delivery and installation of capital equipment, that are an integral part of the transmission line. A return on capital invested in the purchase of real estate for transmission facilities may be allowed provided that the lessee demonstrates the necessity for such purchase, the purchased land is not on a Federal geothermal lease, and MMS approves the deduction; the rate of return shall be the same rate determined in paragraph (b)(2)(v) of this section.

(i) Allowable operating expenses include operations supervision and engineering, operations labor, materials, ad valorem property taxes, rent, supplies, and any other directly allocable and attributable operating expenses that the lessee can document.

(ii) Allowable maintenance expenses include maintenance of the transmission line, maintenance of equipment, maintenance labor, and other directly allocable and attributable maintenance expenses that the lessee can document.

(iii) Overhead directly attributable and allocable to the operation and maintenance of the transmission line is an allowable expense. State and Federal income taxes and severance taxes and other fees, including royalties, are not allowable expenses.

(iv) To compute costs associated with capital investment, a lessee may use either depreciation with a return on undepreciated capital investment, or a return on capital investment. After a lessee has elected to use either method, the lessee may not later elect to change to the other alternative without MMS approval.

(A) To compute depreciation, the lessee must use a straight-line depreciation method based on the expected life of the geothermal project, usually the term of the electricity sales contract or other depreciation period acceptable to MMS. A change in ownership of a transmission line shall not alter the depreciation schedule established by the original lessee-owner for purposes of computing transmission line costs. With or without a change in ownership, a transmission line shall be depre-

cated only once. The rate of return used to compute the return on undepreciated capital investment shall be determined pursuant to paragraph (b)(2)(v) of this section.

(B) To compute a return on capital investment, the allowed cost shall be the amount equal to the allowable capital investment in the transmission line multiplied by the rate of return determined pursuant to paragraph (b)(2)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to transmission lines first placed into service on or after March 1, 1988.

(v) The rate of return shall be 2 times Standard and Poor's industrial BBB bond rate. The rate of return shall be 2 times the monthly average rate as published in Standard and Poor's Bond Guide for the first month of the annual deduction period and shall be effective during the following deduction period. The rate shall be redetermined annually at the beginning of the same month beginning the annual deduction period chosen pursuant to paragraph (b)(1) of this section.

(3) Transmission-line cost rates, determined annually, are computed by dividing the sum of the operating, maintenance, overhead, and capital costs by the annual amount of delivered electricity.

(4) For new transmission lines, the lessee's costs for the first deduction period shall be based on estimated expenses (including overhead) for operating and maintaining the transmission line. For subsequent deduction periods, the transmission line costs shall be estimated based on the lessee's actual operating and maintenance expenses for the previous period adjusted for decreases or increases that the lessee knows will affect the deduction in the current period.

(c) Under no circumstances shall the transmission deduction plus the generating deduction determined pursuant to § 206.354 of this subpart reduce the royalty value of the geothermal resource to zero.

(d)(1) If the actual transmission deduction determined at the end of the annual reporting period is less than the amount the lessee estimated and used

in the netback procedure during the reporting period, the lessee shall be required to pay additional royalties retroactive to the first month of the reporting period, plus interest computed pursuant to 30 CFR 218.302. If the actual transmission deduction is greater than the amount applied in the netback calculation, the lessee shall be entitled to a credit.

(2) Lessees must submit corrected Forms MMS 2014 to reflect adjustments to royalty payments in accordance with MMS instructions.

(e)(1) All transmission deductions are subject to review, audit, and adjustment. When necessary or appropriate, MMS may direct a lessee to modify its estimated or actual transmission deduction and adjust royalty values accordingly.

(2) Pursuant to subpart H of 30 CFR part 212, the lessee must maintain all data and records supporting its transmission deduction, including wheeling and other transmission-related agreements. These data and records must be made available to MMS and other authorized personnel upon request, and shall be maintained in a confidential manner in accordance with applicable laws and regulations pursuant to § 206.352 of this subpart.

(C) A one-time refund of royalties equal to the royalty amount of actual dismantlement costs attributable to the transmission line that are in excess of actual income attributable to the salvage of the transmission line will be allowed at the completion of the dismantlement and salvage operations.

§ 206.354 Determination of generating deductions.

(a) Where the value of geothermal energy is determined by the geothermal netback procedure pursuant to paragraphs (c)(1)(ii) and (d)(1)(ii) of § 206.352 of this subpart, that value shall be determined by deducting the lessee's reasonable actual costs incurred to generate electricity from the plant tailgate value of the electricity (usually the transmission-reduced value of the delivered electricity). Generating deductions are subject to the limitation prescribed in paragraph (c) of this section.

(b)(1) Generating costs shall be based on the lessee's actual annual costs associated with the construction and operation of a geothermal powerplant. The monthly generating deduction is determined by multiplying the annual generating cost rate (in dollars per kilowatthour) by the amount of plant tailgate electricity measured (or computed) for the reporting month. The generating cost rate is determined from the annual amount of plant tailgate electricity and must be redetermined annually at the beginning of the same month of the year in which the powerplant was placed into service or, at the lessee's option, at a time concurrent with the beginning of the lessee's annual corporate accounting period; *Provided*, however, the period selected must coincide with the same period chosen for the transmission deduction pursuant to § 206.353(b)(1). After a deduction period is chosen, the lessee may not later elect to use a different deduction period without MMS approval.

(2) Allowable generating costs include operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment in accordance with paragraph (b)(2)(iv)(A) of this section, or a cost equal to the capital investment in the powerplant multiplied by a rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those costs for depreciable assets, including costs of delivery and installation of capital equipment, that are an integral part of the powerplant or are required by the design specifications of the power conversion cycle. A return on capital invested in the purchase of real estate for a powerplant site may be allowed provided that the lessee demonstrates the necessity for such purchase, the purchased land is not on a Federal geothermal lease, and MMS approves the deduction; the rate of return shall be the same rate determined in paragraph (b)(2)(iv) of this section. The costs of gathering systems and other production-related facilities are not allowed.

(i) Allowable operating expenses include operations supervision and engineering, operations labor, materials, ad

valorem property taxes, rent, supplies, auxiliary fuel and/or utilities used to operate the powerplant during down time, and any other directly allocable and attributable operating expense that the lessee can document.

(ii) Allowable maintenance expenses include maintenance of the powerplant, maintenance of equipment, maintenance labor, and other directly allocable and attributable maintenance expenses that the lessee can document.

(iii) Overhead directly attributable and allocable to the operation and maintenance of the powerplant is an allowable expense. State and Federal income taxes and severance taxes, including royalties, are not allowable expenses.

(iv) To compute costs associated with capital investment, a lessee may use either depreciation with a return on undepreciated capital investment, or a return on capital investment. After a lessee has elected to use either method, the lessee may not later elect to change to the other alternative without MMS approval.

(A) To compute depreciation, the lessee must use a straight-line depreciation method based on the life of the geothermal project, usually the term of the electricity sales contract or other depreciation period acceptable to MMS. A change in ownership of a powerplant shall not alter the depreciation schedule established by the original lessee-owner for computing the generating costs. With or without a change in ownership, a powerplant shall be depreciated only once. The rate of return used to compute the return on undepreciated capital investment shall be determined pursuant to paragraph (b)(2)(v) of this section.

(B) To compute a return on capital investment, the allowed cost shall be the amount equal to the allowable capital investment in the powerplant multiplied by the rate of return determined pursuant to paragraph (b)(2)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to powerplants first placed into service on or after March 1, 1988.

(v) The rate of return shall be 2 times Standard and Poor's industrial BBB bond rate. The rate of return shall be 2

times the monthly average rate as published in Standard and Poor's Bond Guide for the first month of the annual deduction period and shall be effective during the following deduction period. The rate shall be redetermined annually at the beginning of the same month beginning the annual deduction period chosen pursuant to paragraph (b)(1) of this section.

(3) Generating cost rates, determined annually, shall be computed by dividing the sum of the operating, maintenance, overhead, and capital costs by the annual amount of plant tailgate electricity.

(4) For new powerplants, the lessee's generating costs for the first deduction period shall be based on estimated expenses (including overhead) for operating and maintaining the powerplant. For subsequent deduction periods, the generating costs shall be estimated based on the lessee's actual operating and maintenance expenses for the previous period adjusted for decreases or increases that the lessee knows will affect the deduction in the current period.

(c) Under no circumstances shall the generating deduction plus the transmission deduction determined pursuant to §206.353 of this subpart reduce the royalty value of the geothermal resource to zero.

(d)(1) If the actual generating deduction determined at the end of the annual reporting period is less than the amount the lessee estimated and used in the netback procedure during the reporting period, the lessee shall be required to pay additional royalties retroactive to the first month of the reporting period, plus interest computed pursuant to 30 CFR 218.302. If the actual generating deduction is greater than the amount applied in the netback calculation, the lessee shall be entitled to a credit.

(2) Lessees must submit corrected Forms MMS 2014 to reflect adjustments to royalty payments in accordance with MMS instructions.

(e)(1) All generating deductions are subject to review, audit, and adjustment. When necessary or appropriate, MMS may direct a lessee to modify its

estimated or actual generating deduction and adjust royalty values accordingly.

(2) Pursuant to subpart H of 30 CFR part 212, the lessee must maintain all data and records supporting its generating deduction. These data and records must be made available to MMS and other authorized personnel upon request, and shall be maintained in a confidential manner in accordance with applicable laws and regulations pursuant to §206.352 of this subpart.

(f) A one-time refund of royalties equal to the royalty amount of actual dismantlement costs attributable to the powerplant that are in excess of actual income attributable to the salvage of the powerplant will be allowed at the completion of the dismantlement and salvage operations.

§206.355 Valuation standards for direct utilization.

(a) The value of geothermal resources produced for leases subject to this subpart and used in direct utilization processes shall be determined pursuant to this section.

(b)(1)(i) The value of geothermal resources that are sold pursuant to an arm's-length contract shall be the gross proceeds accruing to the lessee, except as provided in paragraphs (b)(1)(ii) and (b)(1)(iii) of this section. The lessee shall have the burden of demonstrating that its contract is arm's-length. The value that the lessee reports for royalty purposes is subject to monitoring, review, and audit.

(ii) In conducting these reviews and audits, MMS will examine whether or not the contract reflects the total consideration actually transferred either directly or indirectly from the buyer to the seller for the geothermal resource. If the contract does not reflect the total consideration, MMS may require that the geothermal resource sold pursuant to that contract be valued in accordance with paragraph (d) of this section. Value shall not be less than the gross proceeds accruing to the lessee, including any additional consideration received.

(iii) If MMS determines that the gross proceeds accruing to the lessee pursuant to an arm's-length contract do not reflect the reasonable value of

the geothermal resource because of misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor, MMS shall require the geothermal resource to be valued pursuant to paragraph (d) of this section and in accordance with the notification requirements of paragraph (c) of this section. When MMS determines that the value may be unreasonable, MMS will notify the lessee and give the lessee an opportunity to provide written information justifying the lessee's value.

(2) The MMS may require a lessee to certify that its arm's-length contract provisions include all of the consideration to be paid by the buyer, either directly or indirectly, for the geothermal resource.

(c)(1) The value of geothermal resources subject to this section that are sold under a non-arm's-length contract shall be determined in accordance with the first applicable of the following paragraphs:

(i) The gross proceeds accruing to the lessee pursuant to a sale under its non-arm's-length contract provided that those gross proceeds are not less than the gross proceeds derived from or paid under the lowest-priced available comparable arm's-length contract for sales of geothermal resources to the lessee-affiliate's same direct utilization facility (the "minimum value"). If the gross proceeds under the lessee's non-arm's-length contract are less than the "minimum value" under available comparable arm's-length contracts, or if there are no available comparable arm's-length contracts, value will be determined by the weighted average of the gross proceeds established under arm's-length contracts for the sale of significant quantities of geothermal resources to the same direct utilization facility. Available contracts will mean contracts in the possession of the lessee, the lessee's affiliate, or MMS. In evaluating the comparability of arm's-length contracts for the purposes of these regulations, the following factors shall be considered: Time of execution, duration, terms, quality of the geothermal resource, volume, dedication to the same direct utilization facility,